FILED

961592 APR 7 1997

OFFICE OF THE CLERK

No. _____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

MARILYN OLKEY, *et al*,

Petitioners,

—v.—

HYPERION 1999 TERM TRUST, INC., *et al*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

ROGER W. KIRBY
KAUFMAN MALCHMAN KIRBY
& SQUIRE, LLP
919 Third Avenue
New York, New York 10022
(212) 371-6600

Counsel of Record for Petitioners

10 pp

QUESTIONS PRESENTED

Over a six-month period in 1992, defendants raised $1.5 billion by express representations that the money would be invested conservatively and provide a yield marginally above U.S. treasuries, no capital appreciation, and commensurately minimal risk to capital. In fact defendants took the money and speculated that interest rates would rise. The speculation failed. About 30% of the capital was destroyed, swiftly. The Second Circuit, in a divided opinion (Newman, C.J., dissenting), acknowledged the express representation, but found that there had been implied (albeit, unrelated) risk disclosures, and affirmed dismissal of the complaint.

The decision presents the following questions:

1. Whether, pursuant to the "bespeaks caution" doctrine, persons who sell securities through offering materials containing express misrepresentations are insulated from liability under the federal securities laws on the basis of generalized, "implicit" cautionary statements that do not bear on the actual misrepresented risks. Seven circuits say they are not; the second circuit says that they are.

2. Whether a court violates the Seventh Amendment when it grants a 12(b)(6) motion (A) based on its own speculation of what plaintiffs might have believed and must have expected, (B) where the sole record evidence consists of numerous contrary and uncontradicted affidavits that state what plaintiffs actually believed and expected, (C) the court's speculation required inferences drawn in favor of movants, and (D) the court's speculation was plainly illogical.

PARTIES TO THE PROCEEDING

This is a class action brought on behalf of purchasers of common stock of defendants Hyperion 1997 Term Trust, Inc., Hyperion 1999 Term Trust, Inc., and Hyperion 2002 Term Trust, Inc. (collectively, "Hyperion" or the "Trusts") in their initial public offerings on June 18 and October 23, 1992. The plaintiffs-petitioners are Marilyn Olkey, Lawrence Berger, Cetinna Camenzuli, Lois F. Dehaven, Cary Pshena, Janis Pshena, Herbert N. Feldstein, Charles Kornberger, Marcella Levy, Michael W. Moran, Milton V. Firestone, Alan Wolf, Leonard Newberger, Robert Perocchia, Madeleine Middlemark, Direct Reproduction Corp., Superimposed Pension Trust #3 Pension Plan Dated 5/12/92, Robert Rattner, Norman Urkowitz, Alvin Goldstein, Harvey Makofsky, and David Masucci (collectively "plaintiffs" or "petitioners"). They brought this suit as a class action on behalf of all others similarly situated.

Defendants are the three closed-end Trusts, their investment advisors, certain officers and directors thereof, and the lead underwriters in the Trusts' public offerings. Specifically, the defendants-respondents are Hyperion 1997 Term Trust, Inc., Hyperion 1999 Term Trust, Inc., Hyperion 2002 Term Trust, Inc., Hyperion Capital Management, Inc., Louis S. Ranieri, Kenneth C. Weiss, David R. Odenath, Jr., Patricia Sloan, Alan M. Mandel, Rodman L. Drake, Garth Marston, Harry E. Petersen, Jr., Leo M. Walsh, Jr., Advest, Inc., Crowell, Weedon & Co., PaineWebber Incorporated, Smith Barney, Harris, Upham & Co., Inc., Kidder Peabody & Co., Inc., Merrill Lynch & Company, Oppenheimer & Co., Prudential Securities, Inc., and Dain Bosworth, Inc.

TABLE OF CONTENTS

QUESTIONS PRESENTED i

PARTIES TO THE PROCEEDING ii

TABLE OF AUTHORITIES v

OPINIONS BELOW 1

JURISDICTION 1

STATUTORY AND REGULATORY PROVISIONS 1

STATEMENT OF THE CASE 2

A. Factual Background 4

B. The Opinions Below 7

1. The District Court's Decision 7

2. The Second Circuit's Split Decision 8

REASONS FOR GRANTING THE PETITION 10

A. The Second Circuit's Application of the Important And Oft-Cited "Bespeaks Caution" Doctrine is Inconsistent With That Of Numerous Other Circuit Courts. 10

B. The Second Circuit Improperly Engaged in Fact-Finding (and Fact-Speculation) on a 12(b)(6) Motion, in Violation of Plaintiffs' Seventh Amendment Rights. 17

CONCLUSION 20

APPENDIX

October 15, 1996 Opinion of the United States Court of Appeals for the Second Circuit 1a

July 14, 1995 Opinion of the United States District Court for the Southern District of New York 29a

January 7, 1997 Order of the United States Court of Appeals for the Second Circuit Denying Petition for Rehearing 46a

September 11, 1995 Order of the United States District Court for the Southern District of New York Denying Plaintiffs' Motion for Reargument and/or Reconsideration 48a

United States Constitution, Seventh Amendment . . . 51a

Rule 12(b) of the Federal Rules of Civil Procedure . . 52a

Section 11(a) of the Securities Act of 1933 (15 U.S.C. § 77k(a)) 54a

Section 12(2) of the Securities Act of 1933 (15 U.S.C. § 77l(2)) 56a

Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b)) 57a

S.E.C. Rule 10b-5 (17 C.F.R. § 240.10b-5) 58a

April 28, 1997 affidavit of Marilyn Olkey 59a

TABLE OF AUTHORITIES

Page

CASES

Conley v. Gibson
355 U.S. 41 (1957) 17

Fecht v. Price Co.,
70 F.3d 1078 (9th Cir. 1995),
cert. denied, __ U.S. __, 116 S.Ct. 1422 (1996) . . 10
12

Gasner v. Board of Supervisors,
103 F.3d 351 (4th Cir. 1996) 13

Gray v. First Winthrop Corp.
82 F.3d 877 (9th Cir.), *reh'g denied*,
1996 U.S. App. LEXIS 14938 (9th Cir. 1996) . . . 12
15

Harden v. Raffensperger, Hughes & Co., Inc.,
65 F.3d 1392 (7th Cir.), *reh'g denied*,
1995 U.S. App. LEXIS 29723 (7th Cir. 1995) . . . 13
15

Huddleston v. Herman & McLean,
640 F.2d 534 (5th Cir. 1981), aff'd in part, rev'd in
part, *Herman & McLean v. Huddleston*, 459 U.S. 375
(1983) 16

In re Donald J. Trump Casino Securities Litigation,
7 F.3d 357 (3d Cir. 1993), *cert. denied*,
510 U.S. 1178 (1994) 10
11
16

In re Silicon Graphics, Inc. Security Litigation,
[1996-97 Tr. Binder] Fed. Sec. L. Rep. (CCH)
¶ 99,325 (N.D. Cal. 1996) 11

In re Westinghouse Securities Litig.,
90 F.3d 696 (3d Cir. 1996) 16

In re Worlds of Wonder Securities Litigation,
35 F.3d 1407 (9th Cir. 1994), *cert. denied*, ___ U.S.
____, 116 S. Ct. 277 (1995) 10
16

Kline v. Western Gov't Sec., Inc.,
24 F.3d 480 (3d Cir.), *cert. denied*,
__ U.S. __, 115 S.Ct. 613 1994) 11

Mayer v. Mylod,
988 F.2d 635 (6th Cir. 1993) 13

Olkey v. Hyperion 1999 Term Trust, Inc.,
98 F.3d 2 (2d Cir. 1996) . . . . . *passim*

Poller v. Columbia Broadcasting System, Inc.,
1368 U.S. 464 (1962) 17

Provenz v. Miller,
102 F.3d 1478 (9th Cir. 1996) 12

Rubinstein v. Collins,
20 F.3d 160 (5th Cir. 1994) 10
13
15

Scheuer v. Rhoades,
416 U.S. 232 (1974) 17

Shaw v. Digital Equipment Corp.,
82 F.3d 1194 (1st Cir. 1996) 13
15

United States v. Morris,
80 F.3d 1151 (7th Cir.),
cert. denied, __ U.S. __, 117 S.Ct. 181 (1996) . . . 15

Virginia Bankshares, Inc. v. Sandberg,
501 U.S. 1083 (1991) 12
13
14

STATUTES, RULES AND REGULATIONS

15 U.S.C. § 77k 1
7

15 U.S.C. § 77l(2) 1
7

15 U.S.C. § 77v 7

15 U.S.C. § 78j(b) 1
7

15 U.S.C. § 78u-5(c) 14

15 U.S.C. § 78aa 7

17 C.F.R. § 240.10b-5 1
7

28 U.S.C. § 1254(1) 1

28 U.S.C. § 1291 8

28 U.S.C. § 1331 7

28 U.S.C. § 1367 7

Federal Rule of Civil Procedure 12(b)(6) 1

Supreme Court Rule 13 1

U.S. Constitution, Seventh Amendment 17

MISCELLANEOUS

H.R. Conf. Rep. No. 104-369, 104th Cong., 1st Sess. (1995) 3

Sec. Reg. & Law (BNA), Vol. 29, No. 12 (March 21, 1997) 11

Martin Flumenbaum and Brad S. Karp, *Second Circuit Review: New York Law Journal*, November 27, 1996 4
18

PETITION FOR A WRIT OF CERTIORARI

Plaintiffs petition for a *writ of certiorari* for a review of the judgment of the United States Court of Appeals for the Second Circuit in this case.

OPINIONS BELOW

The opinion of a divided panel (Newman, C.J., dissenting) of the court of appeals, see Appendix ("App.") 1a-28a, is reported as *Olkey v. Hyperion 1999 Term Trust, Inc.*, 98 F.3d 2 (2d Cir. 1996). The opinion of the United States District Court for the Southern District of New York granting the dismissal motion of defendants-respondents (App. 29a-45a) is reported in LEXIS at 1995 U.S. Dist. LEXIS 10020 and in Westlaw at 1995 WL 422480. The opinion of the United States District Court for the Southern District of New York on plaintiffs' motion for reargument (App. 48a) is reported in LEXIS at 1995 U.S. Dist. LEXIS 13032 and in Westlaw at 1995 WL 539634.

JURISDICTION

The court of appeals entered judgment on October 15, 1996 (App. 1a). A timely petition for rehearing and suggestion for rehearing *en banc* was filed on October 23, 1996, and was denied on January 7, 1997 (App. 46a). This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1) and Supreme Court Rule 13.

STATUTORY AND REGULATORY PROVISIONS

The Seventh Amendment of the United States Constitution; sections 11 and 12(2) of the Securities Act of 1933 (15 U.S.C. §§ 77k and 77l(2)); section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b)); Securities and Exchange Commission Rule 10b-5 (17 C.F.R. § 240.10b-5); and Federal Rule of Civil Procedure 12(b)(6); are reproduced in the appendix at pages 51a-58a.

STATEMENT OF THE CASE

This case presents two issues worthy of *certiorari*. **First**, contrary to the First, Third, Fourth, Fifth, Sixth, Seventh, and Ninth Circuits, the Second Circuit ruled that, as a matter of law, defendants' numerous, precise and explicit representations concerning the investment product sold and risks associated with it were rendered immaterial by generalized cautionary statements that in the event did not relate to risks associated with the product about which the express representations had been made.

Defendants -- who participated in the public offerings of three mutual funds -- represented that they had assembled portfolios designed for conservative investors seeking only modest yields and no capital appreciation. In exchange, the investors would assume minimal risk to capital. The portfolios were to contain a mix of securities with offsetting reactions to interest rate fluctuations so as to keep investors' capital relatively safe, irrespective of the direction of subsequent interest rate movements. Contrary to the specific emphasis on the conservative nature of the investments, defendants had assembled portfolios of securities that were biased towards rising interest rates, and that predictably exposed investors' capital to great risk in declining interest rate environments. As a consequence 30% of the capital was destroyed. *Barrons* observed at the time:

> Hyperion 1999 [is] now . . . down nearly 25% based on its market price. This is far and away the worst showing of any closed-end bond fund, and compares with a gain of 25% for the 10-year Treasury note over the same span.
>
> "'This is one of the worst deals I've ever seen,' [said a president of an investment firm], noting that 'investors thought they were getting a high quality, safe investment. That they should suffer as they have is almost beyond belief.'"

Barrons, October 18, 1993 (quoted at complaint ¶ 16).

The majority opinion of the court of appeals acknowledged that "the prospectuses contain no specific statement that there was a bias in favor of rising interest rates." App. 14a. Nevertheless, it dismissed the claims because of: (a) general cautionary statements, (b) disclosures of risks unrelated to those that actually caused investors' losses, and (c) the presence of "implicit" warnings. This holding contravenes accepted law of seven other circuits. Other circuits have held that only cautionary statements that identify the actual risks provide insulation from federal securities laws' liability. While this action arose prior to the enactment of the Private Securities Litigation Reform Act of 1995 ("PSLRA"), the "bespeaks caution" doctrine remains exceedingly important to federal securities actions of both generations.[1]

Second, the court of appeals granted the 12(b)(6) motion on the basis of its own conceded speculation concerning the possible understanding and intent of investors. The Second Circuit speculated as to the "only" possible belief that reasonable investors could have held concerning the funds' portfolios, and the risk/reward relationships that reasonable investors "could have found" to be "attractive" in making investment decisions. This speculation goes far beyond the scope of a court's powers on a 12(b)(6) motion, which are grounded in the Seventh Amendment. The court's factual speculation also was contrary to more than twenty

---

[1] In enacting the PSLRA, Congress specifically endorsed and encouraged further judicial development of the bespeaks caution doctrine. The "safe harbor" provisions of the PSLRA are based in part on the doctrine, and Congress took special pains to note that it "does not intend for the safe harbor provisions to replace the judicial 'bespeaks caution' doctrine or to foreclose further development of that doctrine by the courts." H.R. Conf. Rep. No. 104-369, 104th Cong., 1st Sess. at 46 (1995). Given this Congressional endorsement, there can be no question that the doctrine continues to be relevant to securities fraud claims, both pre- and post-PSLRA applicability.

investor affidavits in the record.[2] The court of appeals improperly has thus usurped a fact-finding function that is constitutionally the exclusive province of a jury. As reported in the *New York Law Journal:*

> What distinguishes *Olkey*, however, and what makes the decision potentially devastating to securities fraud plaintiffs is the Court's willingness to speculate what "must have been" or "should have been" in minds of investors based on its own reading of prospectuses and related materials -- and to make such "findings" without a single deposition having been conducted.

Martin Flumenbaum and Brad S. Karp, *Second Circuit Review: New York Law Journal*, November 27, 1996, at 3

A. Factual Background

The Trusts issued $1.5 billion of securities at $10 per share. The stated intention of the Trusts was to pay investors annual yields slightly above those obtainable from investments in United States Treasury securities, and to return $10 per share at the conclusions of the Trusts' five-to-ten-year life spans. No assurances were given that the capital would be returned. The assurance upon which this action is founded is the failure to have invested the money in the manner represented.

The prospectus description of a modest yield potential (approximately 1.25% above United States Treasury Securities) and no potential capital appreciation was accompanied by a description of an investment strategy that would provide a commensurately low level of risk to investors. See App. 37a. Each Trust stated that it would invest in a variety of mortgage-

---

[2] A copy of one such affidavit is reproduced in the appendix at 59a.

backed securities that have offsetting reactions to interest rate fluctuations. As a consequence, the Trusts would own balanced portfolios that would be relatively neutral to shifts in interest rates. *See e.g.* App. 9a. According to defendants the Trusts were designed to approximate the interest rate sensitivity of United States Treasury securities. App. 36a. The promise of a conservative, capital protective approach was the principal appeal of the Trusts, and is the reason why they were able to attract so much money so quickly.

The prospectuses stated that the Trusts' investment objectives are "fundamental policies" which "may not be changed without the affirmative vote of the holders of a majority of the outstanding shares". The actionable problem was that defendants pursued a substantially different objective, one that predictably and necessarily carried great risk to the investors' capital, one that soon led to the permanent loss of hundreds of millions of dollars.[3]

---

[3] In his dissenting opinion, Chief Judge Newman provided the following explanation of what happened:

> The fixed-income securities market uses the term "convexity" to describe the degree to which the values of securities are subject to interest rate fluctuations. The term applies primarily to mortgage-backed securities with components of principal and interest. A security that decreases in value in a rising interest rate environment to a greater extent than it increases in value in a declining interest rate environment is said to have "negative convexity." Conversely, a security that increases in value in a declining interest rate environment to a greater extent than it decreases in a rising interest rate environment is said to have "positive convexity." A fund sold as "balanced" can reasonably be expected to try to select securities so that the fund's net convexity approaches zero. If a fund elects not to aim for as much balance as it can achieve and instead bets on a pronounced change in interest rates, it can be so structured (using significant amounts of IO strips)

Each prospectus warned of a possible decrease in the Trusts' yield if interest rates should decline "significantly." App. 22a. There was no warning given of any corresponding risk to investor capital. *The prospectus did not state anywhere, directly or "implicitly", that the investors' money would be used to purchase a completely different product!* The only prospectus warning of a risk to investor capital was the statement that "[n]o assurance can be given that the Trust will achieve its investment objectives, and the Trust may return less than $10 per share". App. 13a. But this action does not depend on such assurances. If defendants had invested as they represented and lost all, there would be no case. It was defendants' inducement to invest on representations of a conservative strategy coupled to the predictably risky strategy actually followed that actuates the cause.

Following limited court-ordered discovery, plaintiffs received internal Hyperion documents. From these an expert determined that when the portfolios had been assembled it was

---

> that its overall value will increase with a rise in interest rates or decrease with declining interest rates. That is what happened with the Hyperion funds. But a "balanced" fund, even one that acknowledges the possibility that significant rate decreases could harm more than significant rate increases could benefit, is still expected to structure the portfolio so that the net convexity is very slight. If the fund managers are secretly betting so heavily on rising interest rates by such a significant inclusion of leveraged IO strips that an interest rate decline will cause substantial decreases, they must say so. Their acknowledgement of the possible differing consequences of significantly decreasing and increasing rates does not reveal that their investment strategy is contrary to what would reasonably be expected of a "balanced" fund.

App. 23a-24a.

foreseeable that they would suffer disastrous losses were interest rates to decline as little as a percentage point during a year. See App. 36a. Interest rates declined in 1993; predictably, investors' capital in the Trusts was permanently destroyed.[4]

The initial complaint in this action was filed on October 18, 1993 in the United States District Court for the Southern District of New York. On February 22, 1994, following the filing of numerous related actions, a consolidated complaint was filed. On November 8, 1994, following a motion by defendants to dismiss and limited court-ordered discovery concerning the initial Trusts' portfolios, plaintiffs filed their second consolidated amended complaint ("complaint").

The complaint asserted claims pursuant to sections 11, 12(2), and 15 of the Securities Act of 1933 ("Securities Act"), sections 10(b) and 20(a) of the Securities Exchange Act of 1934 ("Exchange Act"), SEC Rule 10b-5, and common law fraud. The jurisdiction of the district court was invoked under 28 U.S.C. § 1331, pursuant to section 22 of the Securities Act (15 U.S.C. § 77v), section 27 of the Exchange Act (15 U.S.C. § 78aa), and 28 U.S.C. § 1367.

B. The Opinions Below

1. The District Court's Decision

The district court (Judge Michael B. Mukasey) granted defendants' motion to dismiss, concluding, as a matter of law, that adequate disclosures of an interest rate speculation and the resulting threat to capital had been made in the offering materials. App. 29a *et seq.*

---

[4] On June 14, 1996, after years of denial, defendants acknowledged that the Hyperion 1997 Trust (the first Trust scheduled to terminate) will, in all likelihood, not return $10 per share to investors upon its termination later this year.

Plaintiffs filed a timely motion for reargument, and on September 11, 1995, the district court denied that motion. App. 48a-50a.

2. The Second Circuit's Split Decision

The district court's opinion was appealed to the Second Circuit. It had jurisdiction pursuant to 28 U.S.C. § 1291. By decision and order entered on October 15, 1996, the Second Circuit affirmed the district court's decision. App. 1a.

Contrary to and without bothering even to address the more than twenty, uncontested, investor affidavits that were in the record before the Second Circuit, the majority concluded that: (a) "a reasonable investor could have found the promise of moderate returns attractive despite the risk of substantial losses" (App. 18a); and (b) "the *only* way reasonable investors would . . . invest in the Trusts would be if they believed that the probability of [interest] rates rising exceeded the probability of interest rates dropping." 14a (emphasis in original).

Remarkably, the majority found that the prospectuses contained "assurances of balancing" by defendants concerning the assembly of the Trusts' portfolios (App. 9a), and "agree[d] that the prospectuses contain no specific statement that there was a bias in favor of rising interest rates." App. 14a. Yet, the court *found* that the bias was "implicitly" communicated, 14a, and the prospectus' "assurances were balanced by extensive cautionary language." 10a. But the majority did not identify a single instance, and could not have, where there was any disclosure, even an implicit one, that the money would be invested in a one-way speculation on interest rates that, if it proved wrong, would destroy substantial amounts of the capital invested! The Second Circuit thus engaged in fact-based speculation, drawing necessary inferences in defendants' favor.

In his dissent, Chief Judge Newman recognized that the conclusions drawn by the majority "before any evidence has been presented [are] contrary to Rule 12(b)(6) standards." App. 22a. Judge Newman added that "[n]ot only is the Court's assumption about purchasers of fixed-income securities unsupported by any evidence, it is also highly likely to be incorrect." *Id.* Judge Newman continued:

> To assert, especially in the absence of evidence, that the purchasers of the Hyperion funds bought in the expectation of rising rates, is a proposition at least unsupported and in all likelihood unsupportable. It is possible that a few of the purchasers expected a slight increase in interest rates. Others who bought might have expected a slight decrease in interest rates. Regardless of their expectations as to rates, the repeated assurances that the funds would be "balanced" entitled all of them to believe that the funds would be so structured as to be relatively insulated from any significant rate movements.

App. 23a.

Plaintiffs filed a timely petition for rehearing and suggestion for rehearing *en banc*. On January 7, 1997, the panel denied the petition. App. 46a.

REASONS FOR GRANTING THE PETITION

A. The Second Circuit's Application of the Important And Oft-Cited "Bespeaks Caution" Doctrine is Inconsistent With That Of Numerous Other Circuit Courts.

Seven circuits, consistent with a proclamation of this Court, agree that to render a misrepresentation immaterial as a matter of law, disclosures must be express and tailored to the misrepresented risks. This is known as the "bespeaks caution" doctrine. By its decision in this case, the Second Circuit has parted company. It now holds that by "implicitly" disclosing risks unrelated to the misrepresentations, one is insulated from federal securities law liability.

The "bespeaks caution" doctrine provides "a mechanism by which a court can rule as a matter of law . . . that defendants' forward- looking representations contained enough cautionary language or risk disclosure to protect the defendant against claims of securities fraud." *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1413 (9th Cir. 1994), *cert. denied*, ___ U.S. ____, 116 S.Ct. 277 (1995); *accord Fecht v. Price Co.*, 70 F.3d 1078, 1081 (9th Cir. 1995), *cert. denied*, __ U.S. __, 116 S.Ct. 1422 (1996). The doctrine "is essentially shorthand for the well-established principle that a statement or omission must be considered in context, so that accompanying statements may render it immaterial as a matter of law." *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 364 (3d Cir. 1993), *cert. denied*, 510 U.S. 1178 (1994).

The doctrine was described, in 1994, as representing "a relatively recent, ongoing, and somewhat uncertain evolution in securities law." *Rubinstein v. Collins*, 20 F.3d 160, 167 (5th Cir. 1994). The issue of what qualifies as appropriate cautionary language has been hotly litigated, and will continue to be under the 1995 PSLRA. There have been over 150 reported decisions on the doctrine since 1990, including nearly 30 circuit court opinions, and

the doctrine has been discussed in several opinions since the passage of the PSLRA, including at least one action to which the PSLRA applies.[5] The Ninth Annual Tulane Corporate Law Institute, held March 14, 1997, focused attention on the problems of meaningful cautionary statements, with both corporate counsel and the SEC chairman observing that, rather than providing specific risk disclosures, issuers have been utilizing "kitchen-sink" disclosures, and that no substantial challenges have yet been made over what meaningful cautionary language might be. Sec. Reg. & Law (BNA), Vol. 29, No. 12, pp. 386-87 (Mar. 21, 1997).

Most of the circuits agree that to insulate a defendant from liability, a cautionary statement must be tailored specifically to the misrepresented or omitted risk. As the Third Circuit stated:

> Not just any cautionary language will trigger application of the doctrine. Instead, disclaimers must relate directly to that on which investors claim to have relied . . . "a vague or a blanket (boilerplate) disclaimer, which merely warns the reader that the investment has risks, ordinarily will be inadequate to prevent misinformation. To suffice, the cautionary statements must be substantive and tailored to the specific [representations] in the prospectus which the plaintiffs challenge."

Kline v. Western Gov't Sec., Inc., 24 F.3d 480, 489 (3d Cir. 1994), quoting *Trump*, 7 F.3d at 371-72.[6]

---

[5] See *In re Silicon Graphics, Inc. Sec. Litig.*, [1996-97 Tr. Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,325 (N.D. Cal. 1996).

[6] *Kline* concerned investments in tax shelter instruments from which plaintiffs took deductions that were denied by the IRS. The court held that generalized warnings of the possibility that the I.R.S. would deny the deductions, were insufficient to insulate defendants from

Similarly, the Ninth Circuit's view of the doctrine is:

> A motion to dismiss for failure to state a claim will succeed only when the documents containing defendants' challenged statements include "*enough* cautionary language or risk disclosure," [citation omitted], that "reasonable minds" could not disagree that the challenged statements were not misleading.

Fecht, 70 F.3d at 1082 (emphasis in original).

That court, like the Third Circuit, also observed that the grant of a motion to dismiss grounded on the "bespeaks caution" doctrine is appropriate only when cautionary language is specific enough to warn investors of a certain condition or factor:

> The "bespeaks caution" doctrine is thus wholly consistent with our analysis that whether a statement in a public document is misleading may be determined as a matter of law only when reasonable minds could not disagree as to whether the *mix* of information in the document is misleading. Inclusion of *some* cautionary language is not enough to support a determination as a matter of law that defendants' statements were not misleading.

Id. (citing to *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1097 (1991) (emphasis added, italics in original)). *See also*, *Provenz v. Miller*, 102 F.3d 1478, 1493-94 (9th Cir. 1996) (denying in part defendants' summary judgment motion where "the alleged cautionary statements [were] too general to trigger the 'bespeaks caution' doctrine."); *Gray v. First Winthrop Corp.*, 82 F.3d 877, 884 (9th Cir.), *reh'g denied*, 1996 U.S. App. LEXIS

---

liability for misrepresenting the nature and structure of the entire investment. 24 F.3d at 489.

14938 (9th Cir. 1996) (declining to apply bespeaks caution to risk disclosures that did not "clearly and specifically caution[ ] investors" of the risks that caused the shareholders' injuries).

The Fifth and Seventh Circuits' views are consistent with those of the Third and Ninth Circuits. *See Rubinstein v. Collins*, 20 F.3d at 167-68; *Harden v. Raffensperger, Hughes & Co. Inc.*, 65 F.3d 1392, 1404-05 (7th Cir.) *reh'g denied*, 1995 U.S. App. LEXIS 29723 (7th Cir. 1995) (citing *Virginia Bankshares*; *Worlds of Wonder*; *Trump*; and *Rubinstein*).[7] The Sixth Circuit also applies a narrow view of "bespeaks caution." In *Mayer v. Mylod*, 988 F.2d 635, 639 (6th Cir. 1993), that court, relying on *Virginia Bankshares*, held that not any cautionary statements will render a misrepresentation harmless as a matter of law, but courts must weigh the true and the untrue on a case-by-case basis. Finally, in *Shaw v. Digital Equipment Corp.*, 82 F.3d 1194, 1212-14 (1st Cir. 1996), the First Circuit, relying on, *inter alia*, *Trump*; *Harden*; *Rubinsten*; and *Fecht*, summarized the doctrine as precluding liability "if a statement is couched in or accompanied by prominent cautionary language that clearly disclaims or discounts the drawing of a particular inference." Thus, a majority of circuit courts will not dismiss a securities claim as a matter of law unless the misleading statements are accompanied by meaningful cautionary statements tailored to the specific risks at issue.

The majority view follows logically from the proclamation of this Court in *Virginia Bankshares*, that:

> [N]ot every mixture with the truth will neutralize the deceptive. If it would take a financial analyst to spot the tension between the one and the other,

---

[7] The Fourth Circuit, as well, appears to limit the doctrine's applicability to instances in which the cautionary language is "extensive and meaningful" and "tailored precisely" to the representation at issue. *See Gasner v. Board of Supervisors*, 103 F.3d 351, 359 (4th Cir. 1996).

> whatever is misleading will remain materially so and liability should follow.

501 U.S. at 1097. The Court also stated that misleading statements lose their "deceptive edge" only if "the true statements may discredit the other one[s] so obviously that the risk of real deception drops to nil." *Id.*[8]

In a dramatic and bizarre departure from the accepted view of the bespeaks caution doctrine, the Second Circuit affirmed dismissal as a matter of law here, despite "agree[ing] that the prospectuses contain no specific statement that there was a bias in favor of rising interest rates." App. 14a. The court of appeals' finding rested on prospectus statements that admittedly were not tailored to the risks in question. The court relied on warnings of the risk to "income and dividends" posed by a "significant decline in interest rates," 11a, as well as statements that "changes in interest rates will also lead to changes in the Trust's net asset value." App. 13a. But none of these disclosures so much as whispered that the capital would be invested speculatively or that, by so doing, capital would be placed at great risk. Indeed, the court acknowledged that the "disclosure" "itself is vague -- it does not state whether changes in interest rates could reduce net asset value."[9] Yet, it held that, "the juxtaposition of the two sentences creates an unmistakable inference that a drop in interest rates could decrease net asset value." App. 13a.

---

[8] Consistent with this view, the 1995, PSLRA provides a safe harbor for forward-looking statements accompanied by "meaningful cautionary statements identifying important factors that could cause actual results to differ materially" from the forwarding-looking statements. *See* 15 U.S.C. § 78u-5(c)(1)(A)(i).

[9] In addition to failing to disclose that changes in interest rates can reduce net asset value, the prospectus does not disclose that declines in interest rates can reduce net asset value.

Even if all of this was so, it makes no contact with the reality that the Trusts had been advertising one kind of product (a conservative one, with a balanced portfolio), but were instead selling another (a highly risky one, with a biased portfolio). Under such circumstances, there would not have been, and there was not, *any* correspondence between the risk disclosures and the actual risks.

The only prospectus statement warning of a possible capital impairment was the statement that "[n]o assurance can be given that the Trust will achieve its investment objectives, and the Trust may return less than $10 per Share." *See* App. 13a. This epitomizes the "general" or "boilerplate" warnings that the other circuits and Congress have determined should not supersede specific misrepresentations.[10] Were the law to develop from the decision herein, any issuer could escape all liability simply by including, in a lengthy prospectus containing numerous and specific "assurances," a generic statement, or even the "implicit" intimation, that "this stock might decline in value."

The Second Circuit's application of the "bespeaks caution" doctrine in this case is inconsistent with other circuits in another important respect as well. The other circuits make clear that the "bespeaks caution" doctrine is limited to forward-looking statements. *See Gray*, 82 F.3d at 882 ("the bespeaks caution rule is not applicable to misrepresentations of historical facts"); *Shaw*, 82 F.3d at 1213 (declining to apply "bespeaks caution" doctrine to statement that "has both a forward-looking aspect and an aspect that encompasses a representation of present fact."); *Harden*, 65 F.3d at 1405 (declining to apply doctrine to statement that "constitutes a present assertion of fact" concerning defendants'

---

[10] General "no assurance" warnings were held insufficient to warrant dismissal in *Gray*, 82 F.3d at 883-84; *Harden*, 65 F.3d at 1405-06; and *Rubinstein*, 20 F.3d at 167-68, as well as *United States v. Morris*, 80 F.3d 1151, 1166-68 (7th Cir.), *cert. denied*, __ U.S. __, 117 S. Ct. 191 (1996).

plans); *Rubinstein*, 20 F.3d at 171.[11] As the Fifth Circuit so aptly noted, "To warn that the untoward may occur when the event is contingent is prudent; to caution that it is only possible . . . when [the events] have already occurred is deceit." *Rubinstein v. Collins*, 20 F.3d at 171 (quoting *Huddleston v. Herman & McLean*, 640 F.2d 534, 544 (5th Cir. 1981)), *aff'd* in part, *rev'd* in part, Herman v. McLean v. Huddleston, 459 U.S. 375 (1983).

Hyperion's misrepresentations included statements of present and past conditions, to which the "bespeaks caution" doctrine is, in the view of the majority of circuits, inapplicable. Hyperion's prospectuses falsely stated that the defendants' investment advisor

> has designed the initial composition of the Trust's portfolio[s], and will manage the portfolio[s] on an ongoing basis in an attempt to minimize the impact of changes in interest rates on the net asset value of the portfolio[s].

App. 9a (emphasis added). The portfolios *had been* designed when the representations were made. Thus, the Second Circuit has separated itself from other circuits in its application of bespeaks caution to historical facts. No other circuit tolerates the notion that caution, much less inaccurate or incomplete caution, is a satisfactory substitute for the truth in respect of historical data.

---

[11] *See also In re Westinghouse Securities Litig.*, 90 F.3d 696, 709 (3d Cir. 1996); *In re Worlds of Wonder*, 35 F.3d at 1413; *In re Donald J. Trump*, 7 F.3d at 371.

B. The Second Circuit Improperly Engaged in Fact-Finding (and Fact-Speculation) on a 12(b)(6) Motion, in Violation of Plaintiffs' Seventh Amendment Rights.

All reasonable inferences are drawn in favor of the complaint on a motion to dismiss, and such a motion must be denied "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Scheuer v. Rhoades*, 416 U.S. 232, 236 (1974) (*quoting Conley v. Gibson*, 355 U.S. 41, 45-46 (1957)).

The principle undergirding this fundamental proposition of law lies in the Seventh Amendment's guarantee that "the right to trial by jury shall be preserved and no fact tried by a jury shall otherwise be re-examined in any court of the United States." *See Poller v. Columbia Broadcasting System, Inc.*, 368 U.S. 464, 467 (1962) ("the purpose of the rule [allowing courts to grant judgment as a matter of law] is not to cut litigants off from their right of trial by jury if they really have issues to try.")

The Second Circuit dismissed the complaint here, and trampled over twenty uncontested affidavits, on the strength of speculation as to what investors "could have" been looking for when investing in Hyperion and what they might have believed about certain "implicit" risks. Chief Judge Newman recognized that "[t]o reach this conclusion before any evidence has been presented is contrary to Rule 12(b)(6) [and thus Seventh Amendment] standards." App. 22a.

At the pleading stage of the litigation, the complaint's allegations concerning the likely beliefs of investors must be accepted as true.

The court of appeals, however, ignored this principle and the undisputed record evidence of investor affidavits to speculate that "[t]he *only* way reasonable investors would . . . invest in the

Trusts would be if they believed that the probability of rates rising exceeded the probability of interest rates dropping." App. 14a (emphasis in original). Reasonable investors could have harbored a variety of expectations respecting likely interest rate fluctuations, but that is besides the point. As the Second Circuit's Chief Judge Newman noted in his dissent:

> To assert, especially in the absence of evidence, that the purchasers of the Hyperion funds bought in the expectation of rising rates is a proposition at least unsupported and in all likelihood insupportable. It is possible that a few of the purchasers expected a slight increase in interest rates. Others who bought might have expected a slight decrease in interest rates. Regardless of their expectations as to rates, the repeated assurance that the funds would be "balanced" entitled all of them to believe that the funds would be so structured as to be relatively insulated from any significant rate movements.

App. 23a. The majority's error was exacerbated by the finding that dismissal was warranted, because "a reasonable investor could have found the promise of moderate returns attractive despite the risk of substantial losses . . ." 18a. Such a finding is both improper and absurd. Reasonable people do not assume great risks for small returns.

Courts may not dismiss actions at the pleading stage based on speculation concerning what "could have" happened. Such a holding improperly draws inferences in the movants' favor on a motion to dismiss, and denies plaintiffs their constitutionally-protected right to have a jury of their peers decide what they did or did not expect or believe when making their investment decisions. *See* Martin Flumenbaum and Brad S. Karp, *Second Circuit Review,* N.Y.L.J., November 27, 1996, at 3:

> What distinguishes *Olkey*, however, and what makes the decision potentially devastating to securities fraud plaintiffs is the Court's willingness to speculate what 'must have been' or 'should have been' in minds of investors based on its own reading of prospectuses and related materials -- and to make such 'findings' without a single deposition having been conducted.

Judge Newman was correct when he noted that, "To reach this conclusion before any evidence has been presented is contrary to Rule 12(b)(6) standards." The Second Circuit's curious foray into evidentiary speculation is also contrary to the constitutional principles underlying these standards.

CONCLUSION

The petition for a *writ of certiorari* should be granted.

April 7, 1997

Respectfully submitted,

Roger W. Kirby
(counsel of record)
KAUFMAN MALCHMAN
KIRBY & SQUIRE, LLP
919 Third Avenue
11th Floor
New York, New York 10022
(212) 371-6600

Lead-Counsel for Petitioners

APPENDIX

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 1023—August Term, 1995

(Argued: March 27, 1996 Decided: October 15, 1996)

Docket No. 95-7823

MARILYN OLKEY; LAWRENCE BERGER, CETINNA CAMENZULI; LOIS F. DEHAVEN; GARY PSHENA; JANIS PSHENA; HERBERT N. FELDSTEIN; CHARLES KORNBERGER; MARCELLA LEVY; MICHAEL W. MORAN; MILTON V. FIRESTONE; ALAN WOLF; LEONARD NEWBERGER; ROBERT PEROCCHIA; MADELINE MIDDLEMARK; DIRECT REPRODUCTION CORP., Superimposed Pension Trust #3 Pension Plan Dated May 12, 1992; ROBERT RATTNER; NORMAN URKOWITZ; ALVIN GOLDSTEIN; HARVEY MAKOFSKY; DAVID MASUCCI, on behalf of themselves and all others similarly situated,

Plaintiffs-Appellants,

—v.—

HYPERION 1999 TERM TRUST, INC.; KENNETH C. WEISS; LEWIS S. RANIERI; GARTH MARSTON; RODMAN L. DRAKE; LEO M. WALSH, JR.; PATRICIA A. SLOAN; DAVID R. ODENATH, JR.; PAUL V. IPPOLITO; SMITH BARNEY, HARRIS UPHAM & CO., INC.; KIDDER PEABODY & CO., INC.; MERRILL LYNCH &

COMPANY; OPPENHEIMER & CO.; PRUDENTIAL SECURITIES, INC.; DAIN BOSWORTH, INC., defendants Smith Barney, Harris Upham, Kidder Peabody, Merrill Lynch, Oppenheimer, Prudential, and Dain Bosworth are sued herein individually and as Representatives of defendant Underwriter Class; HARRY E. PETERSEN, JR.; ADVEST, INC.; CROWELL, WEEDON & CO.; HYPERION 1997 TERM TRUST, INC.; HYPERION 2002 TERM TRUST, INC.; PAINEWEBBER INCORPORATED; HYPERION CAPITAL MANAGEMENT, INC.; ALAN M. MANDEL,

Defendants-Appellees.

Before:

NEWMAN, *Chief Judge*,
OAKES, and PARKER, *Circuit Judges*.

A group of investors brought a class action seeking damages for fraud in issuing and using prospectuses to market mortgage-backed securities, in violation of Sections 11, 12(2), and 15 of the Securities Act of 1933 and Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. They also allege common law fraud. Defendants moved for dismissal under Rules 12(b)(6) and 9(b) of the Federal Rules of Civil Procedure. The district court of the Southern District of New York (Michael B. Mukasey, *Judge*) dismissed the suit under Rule 12(b)(6). Plaintiffs appeal.

Judgment affirmed. Chief Judge Newman dissents with a separate opinion.

ROGER W. KIRBY, New York, NY (Irving Malchman, Jeffrey H. Squire, Ira M. Press, Kaufman Malchman Kirby & Squire, LLP, New York, NY, Henry Paul Monaghan, New York, NY, of counsel) *for Plaintiffs-Appellants.*

MICHAEL J. MALONE, New York, NY (Steven B. Carlin, Paul A. Straus, Elizabeth Swire Falker, Battle Fowler LLP, New York, NY, of counsel), *for Defendants-Appellees Hyperion Capital Management, Inc., Lewis S. Ranieri, Kenneth C. Weiss, David R. Odenath, Jr., Patricia Sloan and Alan M. Mandel.*

ALAN J. HRUSKA, New York, NY (Gerald A. Ford, David A. Kotler, Gregory E. Birkenstock, Cravath, Swaine & Moore, New York, NY, of counsel), *for Defendants-Appellees Hyperion 1997 Term Trust, Inc., Hyperion 1999 Term Trust, Inc., Hyperion 2002 Term Trust, Inc., Rodman L. Drake, Garth Marston, Harry E. Petersen, Jr. and Leo M. Walsh, Jr.*

CHARLES A. GILMAN, New York, NY (David G. Januszewski, Jonathan R. Donnellan, Cahill Gordon & Reindel, a partnership

including a professional corporation, New York, NY, of counsel) *for Defendant-Appellee Underwriter Class.*

PARKER, *Circuit Judge*:

Plaintiffs Marilyn Olkey et al., a group of investors, brought a class action against Hyperion 1999 Term Trust, Inc. et al. seeking damages for fraud in issuing and using prospectuses to market mortgage-backed securities, in violation of Sections 11, 12(2), and 15 of the Securities Act of 1933 ("the 1933 Act"), 15 U.S.C. §§ 77k(a), 77l(2), and 77o; and Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 ("the 1934 Act"), 15 U.S.C. § 78j(b), SEC Rule 10b-5, 17 C.F.R. § 240.10b-5, and 15 U.S.C. § 78t(a). They also allege common law fraud. The defendants moved for dismissal under Rules 12(b)(6) and 9(b) of the Federal Rules of Civil Procedure. In a judgment dated July 14, 1995, the district court of the Southern District of New York (Michael B. Mukasey, *Judge*) dismissed the suit under Rule 12(b)(6) for failure to state a claim upon which relief can be granted. *In re Hyperion Sec. Litig.*, No. 93 Civ. 7179 (MBM), 1995 WL 422480. The court held that a reasonable investor would not have been misled by the prospectuses because, on their face, they contained no material misstatements or omissions of fact. The court found the prospectuses accurately represented the investment strategy and provided sufficient explanation of risk. The plaintiffs appeal. We affirm the 12(b)(6) dismissal because the plaintiffs' claims are contradicted by the prospectuses on their face and therefore no set of additional facts could prove the plaintiffs' claims.

I. BACKGROUND

The plaintiffs are a group of more than twenty investors who purchased common stock in three investment companies—Hyperion 1997 Term Trust, Inc., Hyperion 1999 Term Trust, Inc., and Hyperion 2002 Term Trust, Inc. (collectively, "the Trusts"). The investors sue on behalf of themselves and a class of similarly situated investors. The class period extends from June 1992 when the registration statement for Hyperion 1999 became effective and the initial public offering commenced, until October 1993, the date on which the defendants announced that each Hyperion Trust was reducing its dividend. The defendants include the Trusts, Hyperion Capital Management, which served as the investment advisor and administrator of the Trusts, individuals who served as officers or directors of the Trusts or Hyperion Capital, and nine underwriters who participated in the Hyperion offerings.

The Trusts are closed-end investment companies, so they are not obligated to redeem shares bought by investors; investors must resell their shares on the secondary market. The Trusts were formed to invest primarily in mortgage-backed securities. The securities comprising the Trusts included interest-only strips (IOs) of mortgages, which tend to go up with interest rates, and mortgage-backed securities, which tend to go down when interest rates go up. IOs and mortgage-backed securities were intended to balance each other, to serve as a hedge against interest rate changes. Interest rates subsequently declined to historic lows, and the value of the trusts declined.

The plaintiffs alleged that the prospectuses misled investors by indicating that securities would be selected

to achieve a balance such that, as interest rates rose and fell, the value and earnings of the Trusts would remain stable. The plaintiffs contended that this was a misrepresentation because the defendants actually invested in a combination of securities which required rising interest rates to succeed. The plaintiffs further alleged that the defendants failed to disclose the limitations of their hedging strategy, namely, its vulnerability to decreasing interest rates, and that therefore the prospectuses and registration statements misrepresented both the investment strategy of the trust and the risks involved. Finally, the plaintiffs claimed that the defendants misrepresented the riskiness of the Trusts in the presentations, known as roadshows, which they gave to potential brokers.

The plaintiffs claimed that these alleged misrepresentations violate the following securities laws: (1) Section 11(a) of the 1933 Act, 15 U.S.C. § 77k(a), which makes any signer, officer of the issuer or underwriter liable for a registration statement that "contain[s] an untrue statement of a material fact or omit[s] to state a material fact"; (2) section 12(2) of the 1933 Act, 15 U.S.C. § 77l(2), providing for liability for making a securities offering "by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements . . . not misleading"; (3) section 15 of the 1933 Act and section 20(a) of the 1934 Act, 15 U.S.C. § 77o and § 78t(a), providing for liability of controlling persons; (4) section 10(b) of the 1934 Act, 15 U.S.C. § 78j(b), SEC Rule 10b-5, 17 C.F.R. § 240.10b-5, prohibiting fraudulent, material misstatements or omissions in connection with the sale or purchase of a security, *see Luce v. Edelstein*, 802 F.2d 49, 55 (2d Cir. 1986).

The defendants moved to dismiss the claim pursuant to the Federal Rules of Civil Procedure, on two grounds—failure to state a claim upon which relief can be granted under Rule 12(b)(6), and failure to state a fraud claim with sufficient particularity under Rule 9(b).

The district court granted the motion to dismiss the suit pursuant to Rule 12(b)(6), on the ground that the investment strategy and risks were fully revealed on the face of the prospectuses. 1995 WL 422480, at *8. While acknowledging that the roadshows were "more optimistic about risks and returns" than the prospectuses, Judge Mukasey reasoned that reasonable investors would not have relied on oral assurances when they were "contradicted by specific disclosures in the prospectuses." *Id.* at *7-8. The court dismissed the claim without leave to replead because the plaintiffs had already amended their complaint twice. *Id.* at *8. The court did not reach the motion to dismiss under Rule 9(b). It denied a motion for reargument. *In re Hyperion Sec. Litig.*, No. 93 Civ. 7179(MBM), 1995 WL 539634 (S.D.N.Y. Sept. 11, 1995). The plaintiffs appeal.

The plaintiffs offer the following argument: The Trusts were based upon a failed bet that interest rates would rise. The riskiness of this bet was disproportionate to the level of return promised to investors; promised profits were small in comparison to the risk and potential size of losses. This bet was not disclosed to investors. If it had been disclosed, the investors would not have bought shares in the trust because no reasonable investor would accept low return for high risk. The cautionary language in the prospectuses is too general and generic to have alerted investors of the actual risks they faced and should therefore be ignored as boilerplate. These warnings do not mention risk to capital, to

the total value of the portfolio rather than merely components of it. Read as a whole, each prospectus gave the false impression of an attempt to pursue a balanced strategy to minimize risk. In fact, the Trusts speculated on high interest rates. The roadshows compounded the false impression of balance and safety.

II. DISCUSSION

We review *de novo* the district court's dismissal of the complaint under Rule 12(b)(6) and draw all reasonable inferences in the plaintiff's favor. *Jackson Nat'l Life Ins. Co. v. Merill Lynch & Co.*, 32 F.3d 697, 699 (2d Cir. 1994). The complaint may be dismissed under Rule 12(b)(6) "only if it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations." *I. Meyer Pincus & Assoc. v. Oppenheimer & Co.*, 936 F.2d 759, 762 (2d Cir. 1991). The allegations must be well-pleaded. *Papasan v. Allain*, 478 U.S. 265, 283 (1986); *Allen v. Westpoint-Pepperell, Inc.*, 945 F.2d 40, 44 (2d Cir. 1991).

It is undisputed that the prospectuses must be read "as a whole," *see, e.g., McMahan & Co. v. Wherehouse Entertainment, Inc.*, 900 F.2d 576, 579 (2d Cir. 1990), *cert. denied*, 501 U.S. 1249 (1991). It is further undisputed that the "central issue . . . is not whether the particular statements, taken separately, were literally true, but whether defendants' representations, taken together and in context, would have misl[ed] a reasonable investor about the nature of the [securities]," *id.* A prospectus will violate federal securities laws if it does not disclose "material objective factual matters," or buries those matters beneath other information, or treats them cavalierly. *Pincus*, 936 F.2d at 762.

The prospectuses included the following assurances of balancing:

> [T]he Adviser believes that it will be able to manage the composition of the Trust's portfolio in such a manner that any decreases in the value of securities as a result of changes in interest rates will be offset by increases in the value of other securities whose value moves in the opposite direction in response to changes in interest rates, thereby avoiding the realization of capital losses which are not offset by capital gains over the life of the Trust.
>
> . . .

Prospectus for Hyperion 1997 Term Trust, Inc., at 19 (Oct. 23, 1992) ("1997"); Prospectus for Hyperion 1999 Term Trust, Inc., at 16 (June 18, 1992) ("1999"); Prospectus for Hyperion 2002 Term Trust, Inc., at 19 (Oct. 23, 1992) ("2002").

> The Trust's investment in IOs, when combined with other instruments in the Trust's portfolio, is expected to aid the Trust in its attempt to preserve capital. The values of IOs tend to increase in response to changes in interest rates when the values of these other Mortgage-Backed Securities and of Zero Coupon Securities are decreasing, and to decrease when the values of such other instruments are increasing. While the Adviser has no control over changes in levels of interest rates, it has designed the initial composition of the Trust's portfolio and will manage the portfolio on an ongoing basis in an attempt to minimize the impact of changes in interest rates on the net asset value of the portfolio.

1997 at 4; 1999 at 4; 2002 at 4. *See* 1997 at 8-9; 1999 at 6-7; 2002 at 8. Despite these assurances of hedging, we agree with the district court, 1995 WL 422480, at *7, that the prospectuses when read in their entirety are not overly sanguine but instead "bespeak caution," *Pincus*, 936 F.2d at 763; *Luce*, 802 F.2d at 56. The assurances were balanced by extensive cautionary language. The plaintiffs seek to have all of the cautionary language disregarded as boilerplate, but it is too prominent and specific to be disregarded. The prospectuses warn investors of exactly the risk the plaintiffs claim was not disclosed. A reasonable investor could not have read the prospectuses without realizing that, despite the use of balancing[1] in an attempt to minimize the impact of fluctuating interest rates, a significant downturn in interest rates could decrease the value of the Trusts and decrease earnings. The prospectuses included the following warnings about mortgage-backed securities:

> The investment characteristics of Mortgage-Backed Securities differ from traditional debt securities. . . . These differences can result in significantly greater price and yield volatility than is the case with traditional debt securities. As a result, if the Trust purchases Mortgage-Backed Securities at a premium, a prepayment rate that is faster than

---

[1] To the extent that the complaint may be read to suggest that the defendants made no attempt whatsoever to balance, such an allegation is put to rest by the prospectuses themselves. They fully disclosed the actual initial investments with a percentage breakdown and a description of different likely responses to interest rate changes. The plaintiffs do not dispute these percentages but contend that the percentages chosen did not permit a balanced portfolio when interest rates fell. The balancing may have been imperfect, but this is a matter of opinion and judgment—not the basis for a securities fraud claim, which requires a material misrepresentation or omission and is not sustained merely by a claim of poorly implemented investment strategy.

> expected will reduce both the market value and yield to maturity from that which was anticipated. . . .

1997 at 7-8; 1999 at 6; 2002 at 7.

> Because of the effect that changes in interest rates may have on prepayment rates, changes in interest rates may have a greater effect on the value of Mortgage-Backed Securities than is the case with more traditional fixed income securities.

1997 at 9; 1999 at 7; 2002 at 8-9.

> Amounts available for reinvestment by the Trust are likely to be greater during a period of declining interest rates due to increased prepayments and, as a result, likely to be reinvested at lower interest rates than during a period of rising interest rates. Most Mortgage-Backed Securities in which the Trust may invest, like other fixed income securities, tend to decrease in value as a result of increases in interest rates but may benefit less than other fixed income securities from declining interest rates because of the risk of prepayment.

1997 at 13; 1999 at 10; 2002 at 13. In a section set apart under the heading "Risk Factors," the prospectuses even suggested the possibility of precisely the scenario that occurred—namely, interest rates fell, and, because prepayments increased significantly and because of the Trusts' use of leverage, the Mortgage-Backed Securities were an insufficient hedge against the decline in value of the IO strips:

> A significant decline in interest rates could lead to a significant decrease in the Trust's net income and dividends . . . .

> . . . [T]he Trust may be unable to distribute at least $10.00 per share . . . on [its termination date]. . . .
>
> The market prices of [most mortgage-backed securities] may be more sensitive to changes in interest rates than traditional fixed income securities. While the Trust will seek to minimize the impact of such volatility on the net asset value of the Trust's assets, there can be no assurance it will achieve this result. In addition, in the case of an IO, prepayment of the underlying mortgages may result in the Trust's not recouping a portion of its initial purchase price in addition to the loss of interest income. . . . To the extent that the Trust utilizes leverage, the impact . . . of volatility on the Trust's income and net asset value will be magnified.

1997 at 13-14; 1999 at 10-11; 2002 at 13-14 (paragraph headings omitted). *See* 1997 at 32; 1999 at 28; 2002 at 31. The prospectuses stated the intent to use leverage and noted that leverage would "exaggerate the decline in the net asset value or market price of the Shares." 1997 at 13; 1999 at 10; 2002 at 13. *See also* 1997 at 33-34; 1999 at 29-30; 2002 at 33.

The prospectuses repeatedly warned of risk to the entire portfolio:

> [T]he market value of the Trust's portfolio . . . [is] dependant on market forces not in the control of the Adviser.

1997 at 9; 1999 at 7; 2002 at 9.

> [T]he Trust may be unable to distribute to its shareholders at the end of the Trust's term an amount

> equal to at least $10.00 for each Share then outstanding.

1997 at 19; 1999 at 16; 2002 at 19.

> No assurance can be given that the Trust will achieve its investment objectives, and the Trust may return less than $10.00 per Share. A significant decline in interest rates could lead to a significant decrease in the Trust's net income and dividends while a significant rise in interest rates could lead to only a moderate increase in the Trust's net income and dividends. Changes in interest rates will also lead to changes in the Trust's net asset value.

1997 at 2; 1999 at 2; 2002 at 2. The second sentence of this passage—positioned on the second page of each prospectus such that no reasonable reader could miss it—unequivocally states that a drop in interest rates could significantly reduce net income and dividends. The next sentence by itself is vague—it does not state whether changes in interest rates could reduce net asset value, only that they will change net asset value. But the juxtaposition of the two sentences creates an unmistakable inference that a drop in interest rates could decrease net asset value. The two sentences combined elaborate the first sentence by spelling out the condition under which the Trusts could fail to return the investor's money—a significant drop in interest rates.

As stated above, the complaint alleges that investors were misled into believing that their investment would be balanced to remain stable as interest rates rose and fell, when in fact there was an undisclosed bias toward rising interest rates. (The plaintiffs cite, as if it were a smoking gun, the defendants' post-offering report stating that the Trusts were designed "with a bias toward a

rising interest rate environment," Hyperion 1999 Term Trust Semi-Annual Report (May 31, 1993).) The complaint also alleges failure to disclose the risk that falling interest rates could diminish asset value and dividends. The passages quoted above dispose of both of these allegations. While we agree that the prospectuses contain no specific statement that there was a bias in favor of rising interest rates, we find that the prospectuses implicitly and clearly communicated such a bias.

Reasonable investors in the Trusts would hope to preserve capital and earn income. They were informed that the nature of the investment was such that fluctuating interest rates could affect the investment's value. They were told that different types of securities would be affected differently by rising or falling rates and that hedging would be used to minimize those effects. And they were told that a significant decline in interest rates could lead to significant decreases in income and asset values while significant rate increases could lead to only moderate increases in income and asset value. Thus, they were told that the value of losses if rates dropped could exceed the value of profits if rates rose. The *only* way reasonable investors would then invest in the Trusts would be if they believed that the probability of rates rising exceeded the probability of interest rates dropping.

This is the very bias which plaintiffs claim was not disclosed. Reasonable investors would have to be aware that they were risking low returns and erosion of capital if there was a significant drop in interest rates, which is precisely what occurred. Any reasonable investor would have to conclude that the investment objectives could only be achieved here if interest rates rose more than

they fell. No reasonable investor could have relied on perfect balancing because that was not promised.

The dissent believes that this claim should proceed because the fund managers failed to disclose the fact that they were betting on rising interest rates and, therefore, "invested disproportionately in instruments that would benefit from rising rates." ____ F.3d ____. But, the dissent also acknowledges, as it must, that if all that the plaintiffs are claiming is that the fund managers turned out to be "less skillful at balancing their portfolios than the investors hoped[,] . . . their suit would be properly dismissed." ____ F.3d ____. In fact, that is exactly what is being claimed here.

As the dissent indicates, the appellants "do not claim that no balancing occurred; clearly there was some diversification in the portfolios." The prospectuses reveal that a combination of mortgage-backed investments and IO strips were used in an attempt to minimize the impact of interest rate fluctuations. However, the appellants say too much emphasis was placed on IOs because the investment managers believed that interest rates would likely rise.

Every attempt at balancing, of course, must necessarily involve the selection of a mix of investments based in part upon an assessment of what might happen with interest rates; attempting to balance investments in interest-rate sensitive securities without taking prospective rates into account would surely be foolhardy. The plaintiffs are displeased that the fund managers made what turned out to be the wrong assumptions about interest rates while attempting to balance the portfolio. This is not something upon which a fraud claim can be based. Disclosure of the specific reasons for making the invest-

ment choices that were made is not required by the Securities laws. The risks involved, in the event that incorrect choices were made or interest rates fell, were appropriately and fully disclosed.

Despite that, plaintiffs now claim that balancing was not as skillfully done as it should have been. They claim that another set of investment choices should have been made, based upon a different conception of what interest rates would likely do. It is hardly a sound argument, as the dissent suggests, ___ F.3d ___, to say that some other unspecified income funds performed better. That is only to say in hindsight that the managers of those funds turned out to be more skillful in their predictions.

It should also be noted that the alleged undisclosed bias had no direct relationship to the losses claimed to have been incurred. The losses resulted from an extraordinary drop in interest rates. The plaintiffs claim that the failure to disclose the bias toward rising rates masked the fact that this was a high risk/low return investment that they would not have purchased if they had known. The risk, however, was that interest rates would fall or not rise more than they fell. That risk was fully and explicitly disclosed. Therefore, there is no causal relationship between losses claimed to have been suffered and any risk factor not clearly disclosed in the prospectuses.

The plaintiffs repeatedly argue that all of the warnings in the prospectuses should be ignored as boilerplate. Yet, they offer no serious rationale as to why a reasonable investor who was reading the prospectuses would consider the warnings too generic to be taken seriously and, at the same time, would find the sections discussing the opportunities and protections enticingly specific. The

plaintiffs conveniently dismiss as boilerplate anything in the prospectuses that undermines their argument.

The plaintiffs' sole rationale for doing this is that if the warnings are not dismissed as boilerplate, the prospectuses would be read as offering a low return, high risk investment, an impossibly unattractive investment. Hence, the fact, they argue, that the offerings did attract investors must mean that those (presumably reasonable) investors dismissed the cautionary language as boilerplate.

But *any* investment that turns out badly can appear to be—in hindsight—a low return, high risk investment. Not every bad investment is the product of misrepresentation. The fact that interest rates did not rise, and that therefore the Trusts for a period decreased in value as the prospectuses indicated they might, only shows that the investment may have turned out to be a bad one. To show misrepresentation, the complaint must offer more than allegations that the portfolios failed to perform as predicted. *See Friedman v. Mohasco Corp.*, 929 F.2d 77, 79 (2d Cir. 1991). "It is in the very nature of securities markets that even the most exhaustively researched predictions are fallible." *Kramer v. Time Warner Inc.*, 937 F.2d 767, 776 (2d Cir. 1991). "Fraud by hindsight" alone will not sustain a complaint. *Jackson*, 32 F.3d at 703 (quoting *Denny v. Barber*, 576 F.2d 465, 470 (2d Cir. 1978)).

The plaintiffs deny that they are bringing suit merely because they allege the investments turned out badly. They argue that no reasonable investor would seek only modest returns in the face of the risk of substantial losses, as such an offering would constitute a low return, high risk investment. The plaintiffs conclude that, since

there could be no market for such an unattractive investment, prospective investors, reading each prospectus as a whole, necessarily dismissed the cautionary language as boilerplate.

This argument is meritless. Reasonable investors may find the promise of merely modest returns sufficient if they perceive the risk of substantial losses as sufficiently small. Low returns and a low or moderate risk of substantial loss do not equal a low return, high risk investment. The plaintiffs do not even attempt to give any rationale for why a belief at the time of the offerings in a low probability of interest rates dropping significantly would have been unreasonable. Nor do they assert that the defendants should have expected interest rates to drop, let alone to historic lows. *See Lucia v. Prospect St. High Income Portfolio, Inc.*, 36 F.3d 170, 177 (1st Cir. 1994) (affirming summary judgment where plaintiffs "failed to adduce any facts" showing that defendants "could or should have been aware of" plaintiff's analysis at the time of offering).

Since a reasonable investor could have found the promise of moderate returns attractive despite the risk of substantial losses, there is no reason to dismiss the extensive and detailed cautionary language of the prospectuses as boilerplate. That language fully disclosed the risk of investment and was specific enough to warrant a reasonable investor's attention. This court has found language more general than that found in the Hyperion prospectuses to be sufficiently specific to warrant a Rule 12(b)(6) dismissal of a Rule 10b-5 claim. In *Luce*, the offering materials merely warned that potential benefits were "necessarily speculative," that "no assurance could be given that [they] would realized," and "actual results may vary [materially] from the predic-

tions." 802 F.2d at 56 (original brackets omitted). The *Luce* plaintiffs alleged that the defendants promised profits without warning that profits were not guaranteed, while the instant plaintiffs allege the defendants promised a secure investment without warning that preservation of capital was not guaranteed. Both plaintiffs' claims founder on the face of the offering materials.

Made cognizant by the Hyperion prospectuses of the risk posed by declining interest rates, reasonable investors purchased shares of the Trusts in the failed expectation that interest rates would rise. Their expectations were not deceptively manipulated but were simply unmet. The prospectuses contained no material misstatements or omissions of fact, and the plaintiffs fail to state a claim under either the 1933 or 1934 Acts, or under common law fraud.

Dismissal under Rule 12(b)(6) is appropriate because "it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations," *Pincus*, 936 F.2d at 762. Since the plaintiffs' claims are contradicted by the disclosure of risk made on the face of each prospectus, no set of additional facts could prove the plaintiffs' claims. Representations made by the defendants at the roadshows are immaterial since they are contradicted by plain and prominently displayed language in the prospectuses. *See Dodds v. Cigna Sec., Inc.*, 12 F.3d 346, 351 (2d Cir. 1993) ("Nor can a plaintiff rely on misleading oral statements to establish [a Section 10(b)] unsuitability claim when the offering materials contradict the oral assurances"), *cert. denied*, 114 S. Ct. 1401 (1994); *Brown v. E.F. Hutton Group, Inc.*, 991 F.2d 1020, 1031-33 (2d Cir. 1993). This court has consistently affirmed Rule 12(b)(6) dismissal of securities claims where risks are disclosed in the

prospectus. *See Jackson*, 32 F.3d at 703 ("The prospectus fully disclosed the nature of the risks . . . ."); *Luce*, 802 F.2d at 56 (offering materials made clear that benefits were not guaranteed, barring Rule 10b-5 claim); *Pincus*, 936 F.2d at 762 (prospectus made clear "exactly the 'fact' that [plaintiff] contends has been covered up," that shares would more likely trade at a discount than at a premium). The plaintiffs proffer no reasoned basis to dismiss as boilerplate the disclosure of risk contained throughout the prospectuses. "No amount of detail can save [the] complaint when the detail is based on flawed and unreasonable methodologies that lead to unsupported conclusions." *First Nationwide Bank v. Gelt Funding Corp.*, 27 F.3d 763, 772 (2d Cir. 1994), *cert. denied*, 115 S. Ct. 728 (1995).

III. CONCLUSION

The district court properly dismissed this suit pursuant to Rule 12(b)(6). We affirm.

JON O. NEWMAN, *Chief Judge*, dissenting:

I respectfully dissent. This stock fraud claim alleges that the issuers of closed-end funds, formed to invest primarily in mortgage-backed securities, represented that the portfolios would be "balanced," *i.e.*, invested in debt instruments that respond in opposite directions to fluctuations in interest rates, and failed to disclose that the fund managers were in fact betting heavily on rising interest rates and invested disproportionately in instru-

ments that would benefit from rising rates.[2] During the class period, interest rates declined 1.3 percentage points, contrary to the managers' expectation of a rise, and the three funds lost 8.5 percent, 10.5 percent, and nearly 25 percent, respectively, of their net asset values—an outcome that *Barron's* described as "far and away the worst showing of any closed-end bond fund." Complaint ¶ 16. It is undisputed that several months after the prospectuses were issued and the appellants' investments were made, the chairman and chief executive officer of the issuer of the funds disclosed in a report to shareholders that the initial portfolio of one of the funds was designed "with a bias toward a rising interest rate environment."

The Court affirms the dismissal of the complaint for failure to state a claim on the ground that the allegedly

---

[2] Normally, the value of mortgage-backed securities decrease when interest rates increase, and rise when interest rates decline. These effects are enhanced by the change in the rate at which mortgagors elect to pay off their mortgages. When interest rates rise, the pay-off rate declines, and holders of mortgage-backed securities have, in effect, lengthened maturities on average and thereby reduced value. When interest rates decline, the mortgage pay-off rate rises, and holders of mortgage-backed securities have, in effect, shortened maturities on average, received back principal sooner than anticipated, and thereby enhanced value. One way of balancing a portfolio of mortgage-backed securities in order to lessen the effect of interest rate fluctuations is to purchase interest-only securities ("IO strips")—securities that entitle the holder to the interest payments of a mortgage, but no principal payments. IO strips respond to interest rate fluctuations in opposite directions from mortgage-backed securities (both those that entitle the holder to receive principal and interest and those that entitle the holder to receive only principal). Thus, the value of IO strips increases when interest rates rise and decreases when interest rates decline.

The funds in this case included significant amounts of IO strips in anticipation of rising interest rates. Some IO strips were purchased with borrowed funds, and this leveraging accentuated the adverse impact of the decline in interest rates that occurred.

undisclosed bias in favor of rising interest rates was in fact disclosed. Though the Court acknowledges that "the prospectuses contain no specific statement that there was a bias in favor of rising interest rates," ___ F.3d ___, the Court nevertheless concludes that the prospectuses "implicitly and clearly communicated such a bias." ___ F.3d at ___. As evidence, the Court points to a passage in the prospectuses that disclosed that the decrease in net income and dividends that could result from a significant decline in interest rates could be greater than the increase in net income and dividends that could result from a significant rise in interest rates.[3]

The disclosure of these unequal consequences, the majority states, revealed the fund managers' bias toward rising interest rates because "[t]he *only* way reasonable investors would then invest in the Trusts would be if they believed that the probability of rates rising exceeded the probability of interest rates dropping." *Id.* at ___ (emphasis in original). To reach this conclusion before any evidence has been presented is contrary to Rule 12(b)(6) standards, which, as the Court recognizes, prohibit dismissal of a complaint unless "it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations." *I. Meyer Pincus & Associates v. Oppenheimer & Co.*, 936 F.2d 759, 762 (2d Cir. 1991).

Not only is the Court's assumption about purchasers of fixed-income securities unsupported by any evidence, it is also highly likely to be incorrect. Many investors,

---

[3] The key sentence states, "A significant decline in interest rates could lead to a significant decrease in the Trust's net income and dividends while a significant rise in interest rates could lead to only a moderate increase in the Trust's net income and dividends." Prospectus for Hyperion 1997 Term Trust, Inc. at 2. Identical statements were contained in the prospectuses for the 1999 and 2002 funds.

alerted to the possibility that falling interest rates "could" decrease their return in a particular fixed-income fund to a greater extent than rising interest rates "could" raise their return, will nevertheless buy such a fund, if described as "balanced," in the expectation that the fund managers will try to balance their portfolio without a pronounced bias in favor of interest rate movements in either direction. They buy for stable return, slightly above government securities, and for preservation of capital.

To assert, especially in the absence of evidence, that the purchasers of the Hyperion funds bought in the expectation of rising rates is a proposition at least unsupported and in all likelihood unsupportable. It is possible that a few of the purchasers expected a slight increase in interest rates. Others who bought might have expected a slight decrease in interest rates. Regardless of their expectations as to rates, the repeated assurances that the funds would be "balanced" entitled all of them to believe that the funds would be so structured as to be relatively insulated from any significant rate movements.

The fixed-income securities market uses the term "convexity" to describe the degree to which the values of securities are subject to interest rate fluctuations. The term applies primarily to mortgage-backed securities with components of principal and interest. A security that decreases in value in a rising interest rate environment to a greater extent than it increases in value in a declining interest rate environment is said to have "negative convexity." Conversely, a security that increases in value in a declining interest rate environment to a greater extent than it decreases in value in a rising interest rate environment is said to have "positive convexity." A fund sold as "balanced" can reasonably be expected to

try to select securities so that the fund's net convexity approaches zero. If a fund elects not to aim for as much balance as it can achieve and instead bets on a pronounced change in interest rates, it can be so structured (using significant amounts of IO strips) that its overall value will increase with a rise in interest rates or decrease with declining interest rates. That is what happened with the Hyperion funds. But a "balanced" fund, even one that acknowledges the possibility that significant rate decreases could harm more than significant rate increases could benefit, is still expected to structure the portfolio so that the net convexity is very slight. If the fund managers are secretly betting so heavily on rising interest rates by such a significant inclusion of leveraged IO strips that an interest rate decline will cause substantial decreases, they must say so. Their acknowledgement of the possible differing consequences of significantly decreasing and increasing rates does not reveal that their investment strategy is contrary to what would reasonably be expected of a "balanced" fund.

Of course, the investors in such funds have no valid stock fraud claim if fund managers turn out to be less skillful at balancing their portfolios than the investors hoped; if that is all that the appellants in this case were claiming, their suit would be properly dismissed. But they are not alleging unsuccessful balancing. Their claim is that the fund managers misrepresented when they announced their intention to try to balance the funds to an extent that would insulate against significant rate fluctuations, yet planned, from the outset and thereafter, to structure the portfolios in a way that would yield benefits only if their undisclosed bet on rising interest rates was successful.

The Court asserts that the prospectuses

> warn investors of exactly the risk the plaintiffs claim was not disclosed. A reasonable investor could not have read the prospectuses without realizing that, despite the use of balancing in an attempt to minimize the impact of fluctuating interest rates, a significant downturn in interest rates could decrease the value of the Trusts and decrease earnings.

___ F.3d at __ (footnote omitted). This assertion misconceives the risk on which this suit is based. The appellants are not suing because of the disclosed risk that if interest rates declined, asset values would decline. They are suing because of the undisclosed risk that the fund managers would structure the initial portfolios and make investment decisions thereafter by selecting securities that would respond significantly to rate fluctuations that the managers believed, but did not disclose, would be rate rises. The investors accepted the risk that interest rates might decline and that imperfect balancing might cost them some money. They did not accept the risk that a fund, sold as being balanced in order to minimize the effects of interest rate fluctuations, would in fact be deliberately tilted so heavily in the expectation of rising interest rates that a decline in interest rates would incur devastating losses.

It is no answer to suggest that the funds were "balanced" in that they contained some securities whose values would move in opposite directions in response to interest rate fluctuations. Appellants do not claim that no balancing occurred; clearly, there was some diversification in the portfolios. The claim is that whatever balancing occurred was undertaken, initially and thereafter,

on the undisclosed prediction by the fund managers that interest rates would rise. The fact that some mortgage-backed securities and some IO strips were included in the portfolios indicates only that some diversification occurred. The significant losses occurred because of the undisclosed fact that the fund managers, betting heavily on rising interest rates, purchased on a highly leveraged basis a quantity of IO strips of particular rates and maturities to such an extent that interest rate declines proved devastating.

It may well be, as the majority suggests, that portfolio managers of funds claimed to be balanced must inevitably make some predictions about future interest rates. Since it is unlikely that interest rates will remain completely static for any significant period of time, a manager of a balanced portfolio probably makes some prediction of the likely near-term direction of rates. But the whole point of balancing is to structure a portfolio so as to minimize the effects of any interest fluctuations, whether interest rate declines or rises are expected. Even a manager who believes that rates will rise will try to live up to the promise of a balanced fund by selecting a group of securities of low net convexity to guard against the risk of significant loss from rate fluctuations in either direction.

It cannot be maintained that what happened here is simply the inevitable inability of fund managers to balance as skillfully as might have been hoped. The other fixed-income funds that claimed to be balanced survived the modest interest decline that devastated the Hyperion funds. The Hyperion funds ended disastrously not because the managers lacked skill in balancing, but because they bet their investors' money so heavily on rising rates. They were free to market a fund on that

basis and invite investments from those who were also willing to bet heavily on rising interest rates. But they were not free to bet heavily on rising rates and conceal this critical fact from their investors.

In a further effort to bolster the argument that the bias toward rising interest rates was disclosed, the Court points out in a footnote that the prospectuses disclosed percentage breakdowns of the initial portfolio investments. ___ F.3d at ___. The implied point is that these percentage breakdowns enabled investors to make their own determination of the degree to which the portfolio managers were balancing and thereby infer the bias toward rising interest rates inherent in their selection of securities. The appellants respond that disclosure of only the percentages of the portfolio in various forms of securities (*i.e.*, mortgage-backed securities and IO strips) cannot inform an investor of a bias toward rising interest rates in the absence of detail as to the precise nature of the various securities, their interest rates, and their maturities. The appellants are probably correct in their response, but, at a minimum, they are entitled to present evidence to support their basic contention that a reasonable investor, reading the prospectuses, would not have learned that the portfolios were initially invested with a heavy bet on rising interest rates. Even if such an understanding was available as to the initial investments, no reasonable investor could possibly learn that, contrary to the promises to try to balance the funds in the future in an effort to preserve capital and minimize the consequences of interest rate fluctuations, the portfolio managers always intended to reinvest with a distinct bias toward rising interest rates.

The Court also suggests that the undisclosed bias toward rising interest rates did not cause the appellants'

losses, which the Court attributes to declining interest rates. I agree that the appellants cannot claim as damages the *entire* decline in their investment, some part of which is attributable to falling interest rates, but they are entitled to recover the difference between (a) the modest decline that would have occurred if a good faith effort to balance the funds with portfolios of low net convexity had been attempted and (b) the precipitous decline that occurred in the absence of such attempted balancing.

Investors in fixed-income securities or funds of such securities seek rates of return above Treasury issues and accept the risk that unforeseen developments might cause their asset values to drop. But they are entitled to their day in court when they allege, in a detailed complaint, that issuers have promised an attempt to balance a fund to minimize the effects of interest rate fluctuations and have in fact bet heavily on rising interest rates and used the investors' money to make that bet.

For these reasons, I respectfully dissent.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE: HYPERION SECURITIES LITIGATION	:	93 Civ. 7179 (MBM)
	:	OPINION AND ORDER

MICHAEL B. MUKASEY, U.S.D.J.

APPEARANCES:

IRVING MALCHMAN, ESQ.
ROGER W. KIRBY, ESQ.
JEFFREY H. SQUIRE, ESQ.
IRA M. PRESS, ESQ.
Kaufman Malchman Kirby & Squire
(Attorneys for Plaintiffs)
919 Third Avenue
New York, NY 10022
(212) 371-6600

MICHAEL J. MALONE, ESQ.
STEVEN B. CARLIN, ESQ.
PAUL A. STRAUS, ESQ.
ELIZABETH SWIRE FALKER, ESQ.
Battle Fowler LLP
(Attorneys for Defendants Hyperion Capital Management, Inc., Lewis S. Ranieri, Kenneth C. Weiss, David R. Odenath, Jr., Patricia A. Sloan and Alan M. Mandel)
Park Avenue Tower
75 East 55th Street
New York, NY 10022
(212) 856-7171

ALAN J. HRUSKA, ESQ.
Cravath, Swaine & Moore
(Attorneys for Defendants Hyperion 1997 Term Trust, Inc., Hyperion 1999 Term Trust, Inc., Hyperion 2002 Term Trust, Inc., Rodman L. Drake, Garth Marston, Harry E. Petersen, Jr. and Leo M. Walsh, Jr.)
Worldwide Plaza
825 Eighth Avenue
New York, NY 10019
(212) 474-1000

CHARLES A. GILMAN, ESQ.
DAVID G. JANUSZEWSKI, ESQ.
EDWARD T. DARTLEY, ESQ.
Cahill, Gordon & Reindel
(Attorneys for Underwriter Defendants)
80 Pine Street
New York, NY 10005
(212) 701-3000

MICHAEL B. MUKASEY, U.S.D.J.

This class action arises out of plaintiffs' purchase of common stock in three closed-end investment companies, defendants Hyperion 1997 Term Trust, Inc. ("Hyperion 1997"), Hyperion 1999 Term Trust, Inc. ("Hyperion 1999"), and Hyperion 2002 Term Trust, Inc. ("Hyperion 2002"), (collectively, the "Hyperion Trusts" or "Trusts"). Plaintiffs are more than 20 investors who purchased stock in the Hyperion Trusts. Defendants include the Hyperion Trusts, Hyperion Capital Management ("Hyperion Capital"), which served as the investment advisor and administrator for the Hyperion Trusts, individuals who acted as officers or directors of the Hyperion Trusts or Hyperion Capital, and nine representative underwriters which participated in the Hyperion offerings. Plaintiffs claim that the offering materials and supplemental presentations to potential brokers, known as "roadshows," misrepresented the Hyperion Trusts' investment strategy and the attendant risks, in violation of Sections 11, 12(2) and 15 of the Securities Act of 1933, 15 U.S.C. §§ 77k, 771(2) and 77o, Sections 10(b) and 20(a) of the 1934 Act, 15 U.S.C. §§ 78j(b) and 78t(a), Rule 10b-5, 17 C.F.R. § 240.10b-5, and common law fraud.

The original complaint, a consolidation of 16 individual complaints, was filed on February 22, 1994. While a motion to dismiss was pending, and following discovery of documents relating to the Hyperion Trusts' roadshows and initial portfolios, plaintiffs withdrew their consolidated amended complaint and filed a second consolidated amended complaint on November 8, 1994. Defendants now move to dismiss the second consolidated amended complaint, pursuant to Fed. R. Civ. P. 12(b)(6), on the ground that the allegedly inaccurate investment strategy and undisclosed risks were truthfully communicated and fully revealed in the prospectuses, and for failure to satisfy the particularity requirements of Fed. R. Civ. P. 9(b). Because, as discussed below, the offering materials disclosed both the Trusts' investment strategy and the attendant risks, the motion to dismiss is granted.

I.

The following facts and contentions appear in the complaint and documents appended thereto -- specifically, prospectuses for each of the three Hyperion Trusts, and copies of the scripts and slide presentations used during the roadshows. The Hyperion Trusts are closed-end investment companies formed to invest primarily in mortgage-backed securities. (Compl. ¶ 24(a)) The Trusts were designed as a long-term investment which sought to generate a high level of income for investors and return their original investment on a specified date -- five years for Hyperion 1997, seven years for Hyperion 1999, and 10 years for Hyperion 2002. (Compl. ¶ 3) Shares in the Trusts were sold pursuant to a prospectus, and are traded on the New York Stock Exchange. (Compl. ¶¶ 26, 32)

Plaintiffs are members of a class of investors who purchased 63,855 shares for $630,855 in the various Hyperion Trusts during the initial public offerings. (Compl. ¶ 1) The class period extends from June 18, 1992, when the registration statement for Hyperion 1999 became effective and the initial public offering commenced, until October 8, 1993, the date on which defendants announced that each Hyperion Trust was reducing its dividend. (Compl. ¶ 31) Shares in Hyperion 1997 and 2002 were first offered on October 23, 1992. (Id.)

Defendants, those responsible for selling Hyperion stock to plaintiffs, include both institutions and "inside" and "outside" individual defendants. The "inside defendants" include Lewis S. Ranieri, who was responsible for the investment strategy and general oversight of the Trusts, Kenneth C. Weiss, David R. Odenath, Jr., Patricia A. Sloan, and Alan M. Mandel. These defendants served as directors of the Hyperion Trusts, with the exception of Mandel, and all held positions in Hyperion Capital. The "outside defendants," Rodman L. Drake, Garth Marston, Harry E. Petersen, Jr., and Leo M. Walsh, Jr., also served as directors of the Hyperion Trusts. (Compl. ¶ 29) All of the

individual defendants signed the Trusts' registration statements. (Id.) The nine underwriter defendants are Smith Barney Inc., Prudential Securities Inc., Kidder, Peabody & Co., Inc., Merrill Lynch & Co., Inc., Oppenheimer & Co., Inc., Dain Bosworth Inc., Advest, Inc., PaineWebber Inc., and Crowell, Weedon & Co. (Compl. ¶ 30)

Plaintiffs' allegations of misrepresentations and omissions in the offering materials and roadshows fall into two categories: first, the Trusts' investment strategy was misrepresented, and second, the risks were not disclosed. (Compl. ¶ 2) Although plaintiffs complain that the investment objective was misrepresented, in reality, they are complaining that the strategy adopted to pursue that objective was misrepresented. Defendants allegedly misstated the investment strategy by purporting to design "balanced" portfolios that would remain neutral to interest rate fluctuations, when in reality they assembled a "biased" fund skewed in favor of rising interest rates. The second claim, that the true degree of risk was concealed, is related to the first. Plaintiffs argue the prospectuses and sales campaigns characterized the Trusts as a conservative investment and targeted risk-adverse investors. (Compl. ¶ 7) The offering materials purportedly emphasized safety, returns slightly superior than those available from U.S. Treasury securities, and relatively stable net asset values. (Id.) Plaintiffs allege defendants obscured the real risk that investors would sustain a significant and permanent loss of capital if interest rates declined. (Compl. ¶¶ 2(b), 14)

Plaintiffs attempt to bolster their allegations with excerpts from the offering and roadshow materials. The prospectuses allegedly misrepresented the Trusts' investment strategy and policies by claiming that the investment advisers designed the portfolio to balance losses on one type of investment with gains on another, regardless of interest rate fluctuations. For example, under the heading "Investment Objectives and Policies," each Hyperion prospectus explained that the various mortgage-backed

securities comprising the Hyperion Trust portfolios were chosen in an attempt to offset losses with gains:

> [T]he adviser believes that it will be able to manage the composition of the Trust's portfolio in such a manner that any decreases in the value of securities as a result of changes in interest rates will be offset by increases in the value of other securities whose value moves in the opposite direction in response to changes in interest rates, thereby avoiding the realization of capital losses which are not offset by capital gains over the life of the Trust.

(Compl. ¶ 39; Hyperion 1999 at 16; Hyperion 1997 and 2002 at 19)[1]

The prospectuses detailed the composition of the Trusts' portfolios. At the inception, approximately 14% of total Trust assets would be invested in Zero Coupon Securities, 25% in Collateralized Mortgage Obligations ("CMO's"), and the remaining 60% in mortgage-backed securities. (Hyperion 1999 at 15) Of that 60%, approximately half would be invested in Ginnie Mae, Fannie Mae, and Freddie Mac securities. The balance, not to exceed 35%, would be invested in stripped mortgage-backed securities. (Id.) Whereas mortgage-backed securities represent the right to receive payments from loans backed by real estate mortgages, a "stripped" mortgage-backed security separates the pool of mortgages into interest and principal components. (Hyperion 1999 at 6) Thus, interest only securities ("IOs") receive the interest portion of the flow of mortgage payments. (Id.) The prospectuses explained how

---

[1] Cites to Hyperion 1997, 1999 and 2002 are references to the various prospectuses appended to the Consolidated Amended Class Action Complaint as Exhibits A through C, and to the Michael J. Malone Affidavit as Exhibits A through C.

the combination of different mortgage-backed securities could achieve the hoped-for balance:

> The value of IOs tends to increase as [interest] rates rise and decrease as rates fall. The value of the other Mortgage-Backed Securities and Zero Coupon Securities tend to fluctuate inversely with interest rates. Accordingly, the Adviser believes that investment in IOs, in conjunction with other Mortgage-Backed Securities and Zero Coupon Securities, will aid the Trust in its attempt to preserve capital.

(Compl. ¶ 41; Hyperion 1999 at 6-7; Hyperion 1997 at 8-9; Hyperion 2002 at 8) Plaintiffs assert the explanations of the opposing tendencies of mortgage-backed securities and IOs reinforced the prospectuses' representation that the portfolios "would be compiled and managed to attempt to neutralize interest rate fluctuations." (Pls. Mem. Opp'n at 12)

These representations allegedly were augmented by the information conveyed at roadshow presentations. (Compl. ¶ 43) Scripts and slides used during roadshows purportedly promised an "internal balance" which would shelter the net asset value of the investment from wavering interest rates. (Id.) For example, "seesaw" diagrams depicting the opposing tendencies of portfolio securities remained level under various interest rate scenarios. (Compl. ¶ 44) The accompanying script explained "Interest Only strips . . . basically act as an offset and balance the price movement of the other securities in the portfolio. That's what helps us to achieve a relatively stable New Asset Value." (Compl. ¶ 43) Although plaintiffs admit that investors did not view the diagrams or hear the explanations, they allege that defendants intended the brokers and investment advisers in attendance to repeat this information to investors. (Compl. ¶¶ 5, 69)

Plaintiffs contend that the foregoing representations in the prospectuses and roadshows were false, as "Hyperion's portfolios were not intended to be, nor were they, neutral or internally 'balanced.'" (Compl. ¶ 49) Rather, plaintiffs allege the adviser selected a portfolio which would sustain substantial and permanent losses to net asset value if interest rates declined. (Compl. ¶ 50) Plaintiffs claim that based on conditions existing at the time the portfolio was compiled, a 1% decline in interest rates during the first six months would have generated a 13% drop in portfolio value, whereas a 2% rise in interest rates would increase the value of the portfolio by only 4% to 8%. (Compl. ¶ 51) Plaintiffs do not reveal the source of these calculations or the methodology used to obtain them. The complaint refers also to a report issued by Hyperion Capital on June 25, 1993, approximately one year after the Hyperion 1999 offering, which stated:

> [Hyperion Capital] designed the initial portfolio of Hyperion 1999 with a bias toward a rising interest rate environment. In contrast to [Hyperion Capital's] expectation at the time the Trust was invested, interest rates have experienced an ongoing and a substantial decline over the past seven months.

(Compl. ¶ 54) This bias allegedly was concealed by the repeated references to balancing and neutrality in the offering and roadshow materials.

Plaintiffs allege the misrepresentations of the Trusts' investment strategy were accompanied by misrepresentations of the risks inherent in the investment. The prospectuses allegedly characterized the investment as "safe," not only by claiming that the portfolio would be neutral to interest rate fluctuations, but also by representing that the Trust would have an interest rate sensitivity approximately equal to that of a United States Treasury security with a two-, three-, or-five-year maturity. (Compl. ¶ 74; Hyperion 1999 at 4; Hyperion 1997 and 2002 at 5)

Although the prospectuses warned that interest rate changes could affect income, they allegedly reassured investors that the net asset value would remain relatively stable. (Compl. ¶ 74) The prospectuses represented further that the Trust would invest in securities of the finest credit quality -- those issued or guaranteed by the United States government or accorded the highest rating by a rating agency. (Compl. ¶¶ 77-78; Hyperion 1999, 1997 and 2002 at 3) Plaintiffs contend that the roadshows reinforced the alleged message of safety. The roadshow presentation emphasized that because the Hyperion Trust invested in securities of the highest credit quality, it was a relatively safe investment. (Compl. ¶¶ 67-68) The predicted modest yield of approximately 1.25% above comparable treasury securities, but no capital appreciation, was commensurate with a low-risk investment. (Compl. ¶ 70) Plaintiffs claim that despite these representations of safety, the Trusts were likely to incur substantial and permanent losses of capital under reasonably foreseeable interest rate scenarios. (Compl. ¶ 80)

Using these alleged misrepresentations of investment strategy and risk, defendants purportedly targeted risk-adverse investors (Compl. ¶¶ 71-72) who saw the per share price of Hyperion 1997, 1999 and 2002 decline by 16%, 27.5% and 18% respectively during the class period. (Compl. ¶ 15) Investors suffered a total capital loss of more than $325 million. (Id.) Plaintiffs seek to recover their losses as damages for violations alleged in the four counts in their complaint: (1) a violation of Section 11 of the 1933 Act alleging material misrepresentations and omissions in the prospectuses; (2) a violation of Sections 12(2) and 15 of the 1933 Act alleging that the Trusts' shares were sold by means of material misrepresentations and omissions; (3) a violation of Sections 20(a) and 10(b) of the 1934 Act, and Rule 10b-5 promulgated thereunder, alleging fraud in connection with the sale of the Trusts' shares; and (4) common law fraud. Defendants respond with a motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(6), on the ground that the supposedly undisclosed strategy and risks in fact were fully revealed in the offering materials, and

pursuant to Fed. R. Civ. P. 9(b), for failure to plead fraud with particularity. For the reasons set forth below, defendants' motion is granted.

II.

All of the federal securities laws invoked in the complaint require plaintiffs to identify a false statement of material fact or the omission of a material fact. Section 11 of the 1933 Act holds a signer, officer of an issuer, or underwriter liable for a registration statement "contain[ing] an untrue statement of a material fact or omitt[ing] to state a material fact . . . necessary to make the statements therein not misleading." 15 U.S.C. § 77k(a). Section 12(2) of the 1933 Act prohibits any person from offering or selling a security "by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements . . . not misleading." 15 U.S.C. § 771(2). To state a claim under Section 10(b) of the 1934 Act, plaintiffs must allege, inter alia, material misstatements or omissions in connection with the sale or purchase of a security. Luce v. Edelstein, 802 F.2d 49, 55 (2d Cir. 1986). Because the Trusts' strategy and risks were either disclosed or truthfully represented, plaintiffs have failed to identify the material omissions and misrepresentations required to sustain these federal securities laws claims, and accordingly, the complaint must be dismissed.

Plaintiffs posit that the prospectuses concealed the Trusts' true strategy of structuring a portfolio biased in favor of rising interest rates. However, a review of the prospectuses reveals that they discussed candidly both this bias, and the risks posed by interest rate fluctuations. Each prospectus warned, repeatedly, that while the Trust sought to balance gains and losses generated by changes in interest rates, this goal would be more difficult to attain if interest rates declined:

> A significant decline in interest rates could lead to a significant decrease in the Trust's net income and dividends while a significant rise in interest rates could lead only to a moderate increase in the Trust's net income and dividends.

(Hyperion 1999 at 2, 9, 40-41; Hyperion 1997 and 2002 at 2, 11) The prospectuses disclosed that a decline in interest rates could trigger a deluge of mortgage prepayments, resulting in losses to income and dividends. (Hyperion 1999 at 10; Hyperion 1997 and 2002 at 13) The prospectuses explained that as interest rates fell and more homeowners prepaid their mortgages, funds invested in mortgage-backed securities would become available for reinvestment, at lower prevailing interest rates. (Hyperion 1999 at 10; Hyperion 1997 and 2002 at 13) Further disclosures informed potential investors that prepayment could produce an irretrievable loss of capital, and a reduction in income and dividends. (Hyperion 1999 at 11; accord 1997 at 9, 14, 18, 32; Hyperion 2002 at 9, 13-14, 18, 31) Finally, the prospectuses acknowledged that no comparable increase in income and dividends could be expected during periods of rising interest rates, because the resultant reduction in mortgage prepayments would decrease the amounts available for reinvestment at the higher rates. (Hyperion 1999 at 27-28; Hyperion 1997 at 32; Hyperion 2002 at 31)

These disclosures made it apparent that the Trusts were likely to suffer if interest rates declined, and could expect no corresponding benefit if they rose. Yet it is precisely this carefully communicated "bias" in favor of rising interest rates which plaintiffs complain was omitted from the offering materials. References to "balancing" the effects of interest rate fluctuations appeared throughout the prospectuses, but these references were qualified by the caveats described above, and in any event, they were expressed in terms of expectation, not assurance.[2] Heil v.

---

[2] In numerous places, including on the front page of the documents, the prospectuses explained that "[t]he Trust will seek to

Lebow, 91 Civ. 8656, 1994 WL 637686, at *5 (S.D.N.Y. Nov. 14, 1994) (alleged misstatements in roadshows were merely projections, not promises); Brown v. E.F. Hutton Group, 735 F. Supp. 1196, 1199 (S.D.N.Y. 1990) (statements in prospectus that the investment hoped to achieve certain results were nonactionable goals, not guarantees), aff'd, 991 F.2d 1020 (2d Cir. 1993).

Any bias in favor of a rising interest rate environment was further disclosed by a detailed description in the prospectuses of the investment portfolio. Plaintiffs were given a percentage breakdown of the securities comprising the portfolio, and instructed on their differing responses to various interest rates scenarios. These disclosures gave plaintiffs enough information to discern the effects of rising and falling interest rates. Although defendants went beyond merely presenting these facts by articulating the damaging consequences of declining interest rates, they may not have been obligated to offer this explanation. Consolidated Gold Fields, PLC v. Anglo American Corp. of South Africa Ltd., 713 F. Supp. 1457, 1470 (S.D.N.Y. 1989) ("It is . . . sufficient if the company provides information as to material facts in a format from which a reasonable investor could reach his own conclusions as to the risks of the transaction"). Plaintiffs cannot now claim they were unaware of the "real" investment plan when that plan was based on disclosed facts. I. Meyer Pincus & Associates, P.C. v. Oppenheimer & Co., 936 F.2d 759, 763 (2d Cir. 1991); Tabankin v. Kemper Short-Term Global Income Fund, 93 Civ. 5231, 1994 WL 30541, at *4 (N.D. Ill. Feb. 1, 1994).

---

achieve its investment objectives" of providing a high level of income while preserving capital, by investing in a variety of securities which "the Adviser expects" will have differing reactions to changes in interest rates. (Hyperion 1999 at 1-2; Hyperion 1997 and 2002 at 1) (emphasis added) The prospectuses added, "[no] assurance can be given that the Trust will achieve its investment objectives, and the Trust may return less than $10.00 per Share." (Hyperion 1999, 1997 and 2002 at 2) (emphasis added)

Disclosure of the disparate impact of rising and falling interest rates on the Trusts' funds was augmented by thorough disclosure of the attendant risks -- the risk that income, dividends and capital could be reduced, the risk that the balancing objective might not be achieved, and the general risks associated with the investment. Plaintiffs concede that "risks to dividends were represented candidly: if interest rates dropped, so could the dividends as Hyperion reinvested at lower prevailing rates." (Compl. ¶ 2(b)) But the risks threatening capital were revealed with equal candor. The second page of each prospectus warned:

> No assurance can be given that the Trust will achieve its investment objectives, and the Trust may return less than $10.00 per Share . . . Changes in interest rates will also lead to changes in the Trust's net asset value.

(Hyperion 1999, 1997 and 2002 at 2; see also Hyperion 1999 at 3, 10, 11, 16; Hyperion 1997 and 2002 at 3, 13, 16, 19) The prospectuses emphasized the risks to capital despite the investment in high quality securities: "[u]nder certain interest rate or prepayment scenarios, the Trust may fail to recoup fully its investment in [mortgage-backed] securities, notwithstanding the assignment of a rating of AAA to such securities." (Hyperion 1999 at 28; Hyperion 1997 at 32; Hyperion 2002 at 31; see also Hyperion 1999 at 17, 21; Hyperion 1997 at 20, 25; Hyperion 2002 at 20, 24) Although the prospectuses noted that the Trusts would invest only in securities with the highest credit rating, each prospectus clearly stated that credit quality ratings cannot measure the likelihood of prepayment which could threaten income and capital. (Hyperion 1999 at 17; Hyperion 1997 and 2002 at 20) The prospectuses cautioned further that the goal of offsetting gains with losses caused by interest rate fluctuations may not be attained: "While the Trust will seek to minimize the impact of such volatility on the net asset value of the Trust's assets, there can be no assurance that it will achieve this result." (Hyperion 1999 at 11;

Hyperion 1997 at 14, Hyperion 2002 at 13) Finally, the prospectuses imparted a general admonition:

> Given the investment risks described above, an investment in shares of the Trust should not be considered a complete investment program and is not appropriate for all investors. Investors should carefully consider their ability to assume these risks before making an investment in the Trust.

(Hyperion 1999 at 31; Hyperion 1997 and 2002 at 35)

The prospectuses clearly "bespeak caution" through a mantra of caveats, disclaimers, and qualifications. Against this chorus of cautions, plaintiffs cannot claim successfully that the real risks undertaken were not disclosed, I. Meyer Pincus, 936 F.2d at 763; Sable v. Southmark/Envicon Capital Corp., 819 F. Supp. 324, 335-36 (S.D.N.Y. 1993), particularly when the disclosures warned about the very contingencies which came to pass. Jackson Nat'l Life Ins. Co. v. Merrill Lynch & Co., Inc. 32 F.3d 697, 703 (2d Cir. 1994).

The prospectuses themselves refute plaintiffs' allegation that the offering documents included material misrepresentations. To the extent there were any statements that misrepresented either investment strategy or risk, they must be read in relation to the representations and disclosures detailed above. A misrepresentation is material, and therefore actionable, if it significantly alters the total mix of information available to the investors. Brown, 735 F. Supp. at 1201-02, (citing Basic Inc. v. Levinson, 485 U.S. 224, 230-32 (1988)). The central inquiry for determining materiality is "'whether defendants' representations, taken together and in context, would have [misled] a reasonable investor' about the nature of the investment." I. Meyer Pincus, 936 F.2d at 761, (quoting McMahan & Co. v. Wherehouse Entertainment, Inc., 900 F.2d 576, 579 (2d Cir. 1990), cert. denied, 501 U.S. 1249 (1991)). Because references in the prospectus to offsetting gains

with losses, and to safety, appeared amidst abundant factual disclosures and appraisals of risk, the alleged misrepresentations do not rise to the requisite level of materiality. No investor could have believed that net asset values would not be volatile and capital would not be vulnerable unless that investor deliberately ignored explicit warnings, and the securities laws were not meant to shelter those who deliberately disregard disclosed risks. Brown v. E.F. Hutton Group, Inc., 991 F.2d 1020, 1032 (2d Cir. 1993), (citing Royal American Managers. Inc. v. IRC Holding Corp., 885 F.2d 1011, 1015-16 (2d Cir. 1989)).

According to plaintiffs, the alleged misrepresentations and omissions extended beyond the prospectuses into the roadshow presentations used to market the Hyperion Trusts. Plaintiffs contend that scripts and slides used at roadshows highlighted safety and relatively stable net asset values. (Compl. ¶ 6) The roadshow scripts were more optimistic about risks and returns than the prospectuses:

> there are a number of features that really distinguish the Hyperion 1999 Term Trust . . . First of all, the SAFETY inherent in a portfolio that is 100 perce[n]t invested in securities of the HIGHEST CREDIT QUALITY . . . Second, the HIGH CURRENT INCOME your clients will enjoy . . . Third, the STABILITY that is ensured by our portfolio structure. Relative to other instruments that would give you this kind of return, the portfolio provides RELATIVELY STABLE NET ASSET VALUE.

(Compl. Ex. A at 22-23) However, plaintiffs cannot predicate their claims on inferences drawn from statements made during the roadshows, if, as here, those inferences are contradicted by specific disclosures in the prospectuses. Sable, 819 F. Supp. at 334 (reliance on tax opinion unreasonable when opinion contradicted by more detailed disclosure in private placement memorandum);

Brown, 735 F Supp. at 1202 (statements in sales brochure directly refuted by offering memorandum cannot form basis of federal securities law claim). Moreover, a reasonable investor would have familiarized himself with the potential for loss disclosed in the prospectuses, rather than relying on the oral assurances of brokers who attended the roadshows. Marlow v. Gold, 89 Civ. 8589, 1991 WL 107268, at *9 (S.D.N.Y. June 13, 1991) (investor recklessly disregarded written warnings in reliance on oral assurances from accountant); Treacy v. Simmons, 89 Civ. 7052, 1991 WL 67474, at *6 (S.D.N.Y. April 23, 1991) (investor's failure to read risks disclosed in prospectus upon reliance on broker's oral statements unreasonable). Indeed, "any reasonable investor knows to be somewhat wary of a selling agent's oral representations and to check them against the written materials." Brown, 735 F. Supp. at 1202. The written materials available to plaintiffs bristle with warnings which should have caused prospective investors to view with skepticism any assurances of safety and stable net asset values. Because the total mix of information available to the investor must be considered when evaluating liability under the federal securities laws, the contents of the roadshow scripts and slides alone cannot sustain plaintiffs' claims.

* * *

The securities law violations alleged in the amended complaint all depend on the existence of material omissions or misrepresentations. A review of the prospectuses for the Hyperion Trusts reveals that extensive factual disclosures and appraisals of risk refute plaintiffs' claim that defendants omitted or misrepresented material information. Because the offering materials do not supply this essential element, plaintiffs cannot maintain their federal securities claims, and the second consolidated amended complaint is dismissed pursuant to Fed. R. Civ. P. 12(b)(6). The pendent state-law fraud claim in this case, which has not progressed significantly past the pleading stage, should be dismissed for lack of jurisdiction. United Mine Workers of America v. Gibbs, 383 U.S. 715, 726 (1966). After combining 16

individual complaints, submitting a consolidated amended complaint, and filing a second consolidated amended complaint, plaintiffs have taken "more than two bites at an apple they have not been able to get their teeth into." In re Verifone Sec. Litig., 784 F. Supp. 1471, 1486 (N.D. Cal. 1992), aff'd, 11 F.3d 865 (9th Cir. 1993). Accordingly, the second consolidated amended complaint is dismissed without leave to replead.

SO ORDERED:

Dated: New York, New York
July 12, 1995

Michael B. Mukasey,
U.S. District Judge

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
UNITED STATES COURTHOUSE
40 FOLEY SQUARE
NEW YORK 10007

GEORGE LANGE III
CLERK

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 7th day of January one thousand nine hundred and ninety-seven.

Olkey

Plaintiff-Appellant,

v. Docket No: 95-7823

Hyperion 1999 Term

Defendant-Appellee.

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by the appellant Olkey, et al.

Upon consideration by the panel that decided the appeal, it is Ordered that said petition for rehearing is **DENIED**.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges for the court in regular active

service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

FOR THE COURT

GEORGE LANGE III, Clerk

By: _____
Beth J. Meador,
Administrative Attorney

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE: HYPERION SECURITIES LITIGATION	93 Civ. 7179 (MBM) MEMORANDUM AND ORDER

MICHAEL B. MUKASEY, U.S.D.J.

Plaintiffs represent more than 20 investors who purchased common stock in three closed-end investment companies, defendants Hyperion 1997 Term Trust, Inc., Hyperion 1999 Term Trust, Inc., and Hyperion 2002 Term Trust, Inc. (collectively, the "Hyperion Trusts"). Plaintiffs allege that defendants Hyperion Trusts, Hyperion Capital Management, which advised and administered the trusts, individuals acting as officers or directors of these entities, and nine representative underwriters who participated in the Hyperion offerings, violated federal securities laws and committed common law fraud by misrepresenting the Hyperion Trusts' investment strategy and the attendant risks. In a prior opinion, familiarity with which is assumed, defendants' motion to dismiss the second consolidated amended complaint was granted, pursuant to Fed. R. Civ. P. 12(b)(6), because the allegedly inaccurate investment strategy and undisclosed risks were truthfully communicated and fully revealed in the prospectuses. In re Hyperion Sec. Litig., 93 Civ. 7179, 1995 WL 422480 (S.D.N.Y. July 14, 1995).

Plaintiffs now move for reargument or reconsideration of the opinion under Local Civil Rule 3(j) on the basis that the court overlooked 26 affidavits submitted by investors who claimed that they believed the prospectuses characterized the Hyperion Trusts as a safe investment, and that they would not have invested if the true degree of risk had been disclosed. (Pls. Mem. Supp. Recons.

at 2) A motion for reargument should be granted if the movant can demonstrate that the court overlooked factual matters or controlling decisions presented in the earlier motion which, had they been considered, might have altered the result. Monaghan v. SZS 33 Associates, L.P., 153 F.R.D. 60, 65 (S.D.N.Y. 1994); Morse/Diesel, Inc. v. Fidelity and Deposit Co. Of Maryland, 768 F. Supp. 115, 116 (S.D.N.Y. 1991). Because the affidavits were not presented in the prior motion, and because the information contained therein would not have changed the result even if they had been reviewed, plaintiffs failed to satisfy this standard.

Plaintiffs admit that the 26 affidavits were submitted in opposition to defendants' motion to dismiss the first consolidated amended complaint, which was ultimately withdrawn, but were not part of the record on the motion to dismiss the second consolidated amended complaint. (Pls. Mem. Supp. Recons. at 2 n.1) Nevertheless, plaintiffs argue that the affidavits were "capable of being judicially noticed" when the court considered the latter motion. (Id.) Plaintiffs mistakenly equate judicial notice with clairvoyance. Judicial notice can be taken of facts that are brought to the court's attention, not of documents appended to earlier, superseded submissions. Plaintiffs made a tactical decision to exclude the affidavits in opposing defendants' motion to dismiss the second consolidated amended complaint, and cannot now revise their strategy. A motion to reargue is not an occasion to present new facts or theories. Morse/Diesel, Inc., 768 F. Supp at 116-17 (citations omitted); McMahan & Co. v. Donaldson, Lufkin & Jenrette Sec. Corp., 727 F. Supp. 833, 833 (S.D.N.Y. 1989) (citations omitted).

Even if the affidavits had been considered, they would not have influenced the earlier decision. Plaintiffs contend that because the affiants believed Hyperion was a conservative investment, the court usurped the jury's role in finding that no reasonable investor could have failed to appreciate the risks. (Pls. Mem. Supp. Recons. at 1) I concluded that a reasonable investor could not have been misled about the nature and risks of the investment due to the

caveats, disclaimers, and qualifications permeating the prospectuses. In re Hyperion, 1995 WL 422480, at *7. A jury need not consider the issue where, as here, some investors profess to hold beliefs that are expressly contradicted by the written offering materials. I. Meyer Pincus & Associates P.C. v. Oppenheimer & Co., Inc., 936 F.2d 759, 763 (2d Cir. 1991) (securities law claims dismissed because no reasonable investor could have believed prospectus predicted success in light of its express cautions); Brown v. E.F. Hutton Group, Inc., 991 F.2d 1020, 1033 (2d Cir. 1993) (summary judgment granted where "no reasonable investor reviewing the disclosure documents could fail to appreciate that the [investment] could result in a total loss").

Plaintiffs have failed to satisfy the strict standard for granting a motion to reargue because the allegedly overlooked material was not presented and would not have altered the earlier decision. Accordingly, the motion for reargument of the Opinion and Order of this court dated July 14, 1995 is denied.

SO ORDERED:

_____

Dated: New York, New York
September 6, 1995

Michael B. Mukasey,
U.S. District Judge

UNITED STATES CONSTITUTION

SEVENTH AMENDMENT

In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise reexamined in any Court of the United States, than according to the rules of the common law.

FEDERAL RULES OF CIVIL PROCEDURE

RULE 12(b)

Defenses and Objections -- When and How Presented -- By Pleading or Motion -- Motion for Judgment on Pleadings

(b) How Presented. Every defense, in law or fact, to a claim for relief in any pleading, whether a claim, counterclaim, cross-claim, or third-party claim, shall be asserted in the responsive pleading thereto if one is required, except that the following defenses may at the option of the pleader be made by motion: (1) lack of jurisdiction over the subject matter, (2) lack of jurisdiction over the person, (3) improper venue, (4) insufficiency of process, (5) insufficiency of service of process, (6) failure to state a claim upon which relief can be granted, (7) failure to join a party under Rule 19. A motion making any of these defenses shall be made before pleading if a further pleading is permitted. No defense or objection is waived by being joined with one or more other defenses or objections in a responsive pleading or motion. If a pleading sets forth a claim for relief to which the adverse party is not required to serve a responsive pleading, the adverse party may assert at the trial any defense in law or fact to that claim for relief. If, on a motion asserting the defense numbered (6) to dismiss for failure of the pleading to state a claim upon which relief can be granted, matters outside the pleading are presented to and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given

reasonable opportunity to present all material made pertinent to such a motion by Rule 56.

Securities Act of 1933
Section 11(a) (15 U.S.C. § 77k(a))

Civil liabilities on account of false registration statement
Persons possessing cause of action; persons liable

(a) In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue --

(1) every person who signed the registration statement;

(2) every person who was a director or (or person performing similar functions) or partner in the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;

(3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;

(4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation which purports to have been prepared or certified by him;

(5) every underwriter with respect to such security.

If such person acquired the security after the issuer has made generally available to its security holders an earning statement covering a period of at least twelve months beginning after the effective date of the registration statement, then the right of recovery under this subsection shall be conditioned on proof that such person acquired the security relying upon such untrue statement in the registration statement or relying upon the registration statement and not knowing of such omission, but such reliance may be established without proof of the reading of the registration statement by such person.

Securities Act of 1933
Section 12(2) (15 U.S.C. § 77l(2))

Civil liabilities arising in connection with prospectuses and communications

Any person who --

> (2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

Securities Exchange Act of 1934
Section 10(b) (15 U.S.C. § 78j(b))

Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange --

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

S.E.C. Rule 10b-5 (17 C.F.R. § 240.10b-5)

Employment of Manipulative and Deceptive Devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange.

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE: HYPERION SECURITIES LITIGATION	:	Civil Action No. 93 Civ. 7179 (MEM)
THIS DOCUMENT RELATES TO ALL ACTIONS	:	

STATE OF NEW YORK)
: S.S.
COUNTY OF QUEENS)

MARILYN OLKEY, being duly sworn, deposes and says:

1. I reside in Little Neck, New York, and purchased 400 shares of the Hyperion 1999 trust in the June 1992 offering thereof.

2. I originally learned of the Hyperion 1999 trust from my broker, Joel Gerber of Prudential Securities, in the Spring of 1992. I am generally conservative investor and am willing to forego a potentially lucrative return in exchange for a safe, secure investment. When making investments decisions, I consider safety to be my paramount consideration. Mr. Gerber, who had been my broker for over a decade was well aware of my objectives.

3. My broker informed me that the Hyperion 1999 trust was a low-risk investment with minimal volatility. I

was also informed that there was little risk to my principal by investing in Hyperion 1999. Accordingly, I was told that Hyperion 1999 was a suitable investment for my conservative objectives. In fact, I invested a portion of my I.R.A. in the Hyperion trust, because I believed it was a suitable investment for my retirement funds.

4. Based upon the recommendation of my broker, I invested $4,000.00 in Hyperion 1999.

5. I never would have invested my Hyperion 1999 had I known that Hyperion 1999 was heavily biased towards rising interest rates and that a moderate decline in interest rates could have a potentially devastating effect on my investment.

_____

MARILYN OLKEY

Sworn to before me this
28th day of April, 1994

_____

2

No. 96-1592

Supreme Court, U.S.
FILED
MAY 8 1997
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

MARILYN OLKEY, *et al*,

Petitioners,

—v.—

HYPERION 1999 TERM TRUST, INC., *et al*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION

MICHAEL J. MALONE
STEVEN B. CARLIN
PAUL A. STRAUS
BATTLE FOWLER LLP
75 East 55th Street
New York, New York 10022
(212) 856-7171

Counsel of Record for Respondents Hyperion Capital Management, Inc., Lewis S. Ranieri, Kenneth C. Weiss, David R. Odenath, Jr., Patricia A. Sloan and Alan M. Mandel

May 8, 1997

21

QUESTIONS PRESENTED

1. Whether a court may dismiss a federal securities law action based on alleged prospectus misstatements where plaintiffs' allegations are contradicted by the language of the prospectus.

2. Whether, on a motion to dismiss federal securities law claims pursuant to Rule 12(b)(6), the district court was required to take judicial notice of affidavit assertions about the subjective beliefs of particular investors where the affidavits were never even submitted on the motion and the language of the prospectuses at issue fully disclosed the allegedly concealed risks.

LIST OF INTERESTED PARTIES AND RULE 29.6 STATEMENT

The petitioners are Marilyn Olkey, Lawrence Berger, Cetinna Camenzuli, Lois F. Dehaven, Gary Pshena, Janis Pshena, Herbert N. Feldstein, Charles Kornberger, Marcella Levy, Michael W. Moran, Milton V. Firestone, Alan Wolf, Leonard Newberger, Robert Perocchia, Madeleine Middlemark, Direct Reproduction Corp. Superimposed Pension Trust #3 Pension Plan Dated 5/12/92, Robert Rattner, Norman Urkowitz, Alvin Goldstein, Harvey Makofsky and David Masucci.

The respondents are Hyperion 1999 Term Trust, Inc.; Hyperion 1997 Term Trust, Inc.; Hyperion 2002 Term Trust, Inc.; Painewebber Incorporated; Hyperion Capital Management, Inc.; Alan M. Mandel; Kenneth C. Weiss; Lewis S. Ranieri; Garth Marston; Rodman L. Drake; Leo M. Walsh, Jr.; Patricia A. Sloan; David R. Odenath, Jr.; Paul V. Ippolito; Smith Barney, Harris Upham & Co., Inc.; Kidder Peabody & Co., Inc.; Merrill Lynch & Company; Oppenheimer & Co.; Prudential Securities, Inc.; Dain Bosworth, Inc.; Harry E. Petersen, Jr.; Advest, Inc.; and Crowell, Weedon & Co.

Pursuant to Rule 29.6 of this Court, respondent Hyperion Capital Management, Inc. ("HCM") states that the following are registered, public investment companies to which HCM serves as investment adviser:

The Hyperion Total Return Fund, Inc.;

Hyperion 1997 Term Trust, Inc.;

Hyperion 1999 Term Trust, Inc.;

Hyperion 2002 Term Trust, Inc.;

Hyperion 2005 Investment Grade Opportunity Term Trust, Inc.;

Hyperion Short Duration U.S. Government Fund (a series of Hyperion Government Mortgage Trust);

Hyperion Short Duration U.S. Government Fund II (a series of Hyperion Government Mortgage Trust II); and

Short Duration U.S. Government Portfolio (in which the Short Duration Funds invest their assets).

TABLE OF CONTENTS

	PAGE
Questions Presented	i
List of Interested Parties and Rule 29.6 Statement	ii
Table of Contents	iv
Table of Authorities	vi
Counter Statement of the Case	1
A. Counter Statement of Facts	1
B. Course of Proceedings and Disposition of the Case Below	3
The Decisions Below	3
Summary of Argument	4
Reasons for Denying the Writ	5
I. The Second Circuit's Decision Is a Routine Application of Well-Settled Federal Securities Law and Creates No Conflict Among the Circuits	5
A. The Second Circuit Applied the Same Standard Applied by Every Circuit	5
B. The Second Circuit Properly Held the Risk Disclosure in These Prospectuses Disclosed the Trusts' Risks to Reasonable Investors	7

PAGE

II. Petitioners Have Not Raised any Issue Under the Seventh Amendment 11

Conclusion 12

Appendix 1a

TABLE OF AUTHORITIES

Cases: PAGE

Brown v. E.F. Hutton Group, 735 F. Supp. 1196 (S.D.N.Y. 1990), *aff'd*, 991 F.2d 1020 (2d Cir. 1993) 10

Fecht v. Price Co., 70 F.3d 1078 (9th Cir. 1995), *cert. denied*, ___ U.S. ___, 116 S. Ct. 1422 (1996) 7

I. Meyer Pincus & Assocs., P.C. v. Oppenheimer & Co., 936 F.2d 759 (2d Cir. 1991) 6

In re Donald J. Trump Casino Sec. Litig., 7 F.3d 357 (3d Cir. 1993), *cert. denied*, 510 U.S. 1178 (1994) 6

In re RAC Mortgage Inv. Corp. Sec. Litig., 765 F. Supp. 860 (D. Md. 1991) 10

In re Stac Elecs. Sec. Litig., 89 F.3d 1399 (9th Cir. 1996), *cert. denied*, ___ U.S. ___, 117 S. Ct. 1105 (1997) 5

In re Worlds of Wonder Sec. Litig., 35 F.3d 1407 (9th Cir. 1994), *cert. denied*, ___ U.S. ___, 116 S. Ct. 185 (1995) 6

Kas v. Financial Gen. Bankshares, Inc., 796 F.2d 508 (D.C. Cir. 1986) 10

Kowal v. MCI Communications Corp., 16 F.3d 1271 (D.C. Cir. 1994) 10

Melder v. Morris, 27 F.3d 1097 (5th Cir. 1994) 5

Olkey v. Hyperion 1999 Term Trust, Inc., 98 F.3d 2 (2d Cir. 1996) 4

PAGE

Raab v. General Physics Corp., 4 F.3d 286 (4th Cir. 1993) 6

Rudolph v. United States, 370 U.S. 269 (1962)..... 6

Silver v. H&R Block, Inc., 105 F.3d 394 (8th Cir. 1997) 5

Sinay v. Lamson & Sessions Co., 948 F.2d 1037 (6th Cir. 1991) 6

Suna v. Bailey Corp., 107 F.3d 64 (1st Cir. 1997) 5

Wills v. Texas, 511 U.S. 1097 (1994) 11

RESPONDENTS' BRIEF IN OPPOSITION

Respondents respectfully submit that a writ of *certiorari* to review the judgment of the United States Court of Appeals for the Second Circuit entered on October 15, 1996 should not issue because petitioners present no question worthy of the exercise of this Court's *certiorari* jurisdiction and because the decision below is in all respects correct.

COUNTER STATEMENT OF THE CASE

A. Counter Statement of Facts

This case concerns federal securities law claims[1] against three closed-end investment companies (the "Trusts"). Each Trust was formed in 1992 to invest in a portfolio consisting principally of mortgage-backed securities. Each had two stated investment objectives: to provide a relatively high level of current income; and to return the initial public offering price of $10 per share to investors at the termination dates of the Trusts in 5, 7 and 10 years, respectively.

Each prospectus[2] described in detail the nature and characteristics of the different types of mortgage-backed securities and other instruments in which the Trust could invest, and set forth an anticipated portfolio, including particular per-

---

1. This case does not present any issues for review under the new Private Securities Litigation Reform Act of 1995 (the "PSLRA"). The Complaint in this action was filed before the effective date of the PSLRA, and no party in this action has ever urged that the new statute should be applied retroactively to the Complaint. Both the District Court and the Second Circuit relied on the body of law that was in effect before the PSLRA.

2. A copy of each of the prospectuses for the three Trusts was included in the Joint Appendix filed by petitioners on their appeal to the Second Circuit. References to that Joint Appendix are indicated as "A. ___." The prospectuses were incorporated by reference in the Complaint. A.146.

centages for each type of instrument in which the Trust expected it would initially invest. A.287-295, 352-359, 423-430, 532. The prospectuses warned investors that the Trusts were expected to invest heavily in mortgage-backed securities, and that the Trusts' portfolios of mortgage-backed securities would be particularly sensitive to interest-rate fluctuations. The prospectuses explicitly warned that the underlying mortgages could (like any mortgage) be prepaid at any time, that a decline in interest rates could trigger a rise in mortgage refinancings and prepayments, and that such an event posed a risk to investors' capital. *See* sec. I.B below.[3]

The prospectuses stated that the Hyperion defendants would attempt to manage the portfolios so as to reduce the risks of this interest rate sensitivity. Nevertheless, each prospectus also made clear that the success of this strategy could not be guaranteed. A.280, 343, 414.

In 1993, interest rates plunged to "historic" lows. A.476-480, 514-517.[4] Homeowners rushed to refinance their mortgages at these exceptionally low rates, which caused an "unprecedented" and "record level" rise in mortgage prepayments. A.478, 479, 480. This wave of prepayments had the precise effect on the Trusts that the prospectuses had warned about. By October 8, 1993, each of the Trusts' net asset values had declined, and each of the Trusts announced that it was reducing its dividend. The first lawsuit was filed just 10 days later.

---

3. The detailed prospectus disclosures (*see* sec. I.B below) regarding the volatile instruments whose interest-rate sensitivities the Trusts would attempt to manage directly contradict petitioners' claim that there was only one warning regarding risk to capital (Petition at 6) or that the prospectuses indicated that there would be "minimal risk to capital" (Petition at 2).

4. Opinion at 16a (citing "extraordinary drop" in interest rates).

B. Course of Proceedings and Disposition of the Case Below

In all, sixteen separate class-action complaints were filed against the Trusts in the weeks following the announcement that the Trusts were reducing dividends. A.7. The district court consolidated these separate actions and when petitioners eventually filed their Second Consolidated Amended Complaint (the "Complaint")[5] defendants moved to dismiss that pleading. A.11.

The Decisions Below. In an opinion and order dated July 12, 1995 (A.527-545), the Hon. Michael B. Mukasey, J., dismissed petitioners' claims. The district court found that the prospectuses "discussed candidly" the very facts petitioners claim were concealed (A.537), and that the prospectuses fully disclosed "both the Trusts' investment strategy and the attendant risks". A.529. Petitioners moved for reargument, relying on various investor affidavits that had not been part of the record on the motion to dismiss the Complaint.[6] On September 6, 1995 the district court denied petitioners' motion for reargument. A.50.

In an opinion dated October 15, 1996 (the "Opinion"), a majority of the Second Circuit affirmed (2-1) the district court's opinion, holding that the prospectuses would not have

---

5. Petitioners initially filed a consolidated amended complaint which defendants promptly moved to dismiss for failure to state a claim. After that motion had been fully briefed, the court permitted petitioners to obtain limited discovery and to file a second amended complaint despite the pending motion to dismiss.

6. Petitioners now describe the affidavits as "record evidence" (Petition at i) and attack the court of appeals for supposedly not "bothering" to address them (Petition at 8). They do not advise this Court that the district court held the affidavits "were not part of the record on the motion to dismiss the second consolidated amended complaint. . . . Plaintiffs made a tactical decision to exclude the affidavits in opposing defendants' motion to dismiss the second consolidated amended complaint, and cannot now revise their strategy." Reargument Order at 49a.

misled a reasonable investor concerning the nature and risks of the investment. Opinion at 8A-19a.[7]

Petitioners filed a petition for rehearing by the panel and a suggestion for hearing by the Second Circuit *en banc*. In that brief, petitioners for the first time raised the argument that the district court and Second Circuit decisions violated petitioners' constitutional rights. On January 7, 1997, the panel denied petitioners' request for rehearing, and the Second Circuit declined to hear this case *en banc*.

SUMMARY OF ARGUMENT

This case presents no issue even remotely worthy of a grant of *certiorari*. The prospectuses at issue were incorporated by reference in plaintiffs' complaint. The Second Circuit reviewed the language of those prospectuses applying the same standard used in every circuit: it read the prospectuses to determine whether their language, in context, disclosed to a reasonable investor the risks plaintiffs claim were concealed. Contrary to petitioners' argument, the court did not rest its holding on disclosure that was "boilerplate," "vague" or "not tailored" to the risks. Petition at 14, 15. Instead, the court determined that the prospectuses "fully and explicitly" warned of "exactly the risk the plaintiffs claim was not disclosed" in language that was "extensive," "detailed," and "too prominent and specific to be disregarded." Opinion at 10a, 16a, 18a. Quite apart from the correctness of the decision below, the role of this Court is surely not to repeat the lower courts' extensive analysis of the prospectuses. The fact that petitioners disagree in this case with the outcome of the Sec-

---

7. The Opinion was reported as *Olkey v. Hyperion 1999 Term Trust, Inc.*, 98 F.3d 2 (2d Cir. 1996). For the Court's convenience, citations to the Opinion are given as page references to the Appendix to the Petition.

ond Circuit's application of that well-accepted standard does not give rise to a conflict among the circuits.

Petitioners' argument that the dismissal violates their Seventh Amendment right to a jury was raised for the first time in petitioners' petition for rehearing and suggestion for rehearing *en banc* by the Second Circuit and should not even be considered by this Court. In any case, because the courts below properly dismissed the Complaint under well-worn principles of Fed. R. Civ. P. 12(b)(6), plaintiffs' purported constitutional claim is meritless.

REASONS FOR DENYING THE WRIT

I. The Second Circuit's Decision Is a Routine Application of Well-Settled Federal Securities Law and Creates No Conflict Among the Circuits.

A. The Second Circuit Applied the Same Standard Applied by Every Circuit

In holding that the prospectuses at issue contained no material misrepresentations, the Second Circuit applied the same federal securities law standard followed by every other circuit. The court determined as a matter of law "whether defendants' representations, taken together and in context, would have misled a reasonable investor." Opinion at 8a (internal quotations omitted). Regardless of what that analysis is called, all circuits hold that if no "reasonable investor" could conclude that the statements, "taken together and in context, were misleading, then the issue is appropriately resolved as a matter of law." *Silver v. H&R Block, Inc.*, 105 F.3d 394, 396 (8th Cir. 1997) (affirming dismissal).[8]

---

8. *Accord Suna v. Bailey Corp.*, 107 F.3d 64, 70 (1st Cir. 1997) (affirming dismissal); *In re Stac Elecs. Sec. Litig.*, 89 F.3d 1399, 1408-09 (9th Cir. 1996) (same), *cert. denied*, ___ U.S. ___, 117 S. Ct. 1105 (1997); *Melder v. Morris*, 27 F.3d 1097, 1101 (5th Cir. 1994) (same); *In*

Petitioners cannot seriously dispute that the Second Circuit applied this standard.[9] At most, petitioners quarrel with the Court's conclusion that in this instance:

> A reasonable investor could not have read the prospectus without realizing that, despite the use of balancing . . . in an attempt to minimize the impact of fluctuating interest rates, a significant downturn in interest rates could decrease the value of the Trusts and decrease earnings.

Opinion at 10a. That petitioners disagree with the outcome of the lower courts' analysis of the prospectus language in this case does not create a "split" in the circuits or an issue worthy of review by this Court.[10]

Struggling to manufacture some certworthy issue in this routine securities action, petitioners also make much of the "bespeaks caution" doctrine, which has been generally accepted by the circuits. Petition at 10-13. The doctrine, however, is no more than a specific formulation of the rule the Second Circuit followed, as petitioners' own authorities show: "[T]he bespeaks caution doctrine reflects the unremarkable proposition that statements must be analyzed in context." *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1414

---

re Donald J. Trump Casino Sec. Litig., 7 F.3d 357, 369 (3d Cir. 1993) (same), *cert. denied*, 510 U.S. 1178 (1994); *Raab v. General Physics Corp.*, 4 F.3d 286, 290 (4th Cir. 1993) (same); *Sinay v. Lamson & Sessions Co.*, 948 F.2d 1037, 1040 (6th Cir. 1991) (same); *I. Meyer Pincus & Assocs., P.C. v. Oppenheimer & Co.*, 936 F.2d 759, 763 (2d Cir. 1991) (same).

9. Indeed, even the dissent below did not disagree with the majority's statement of the law. Opinion (dissent) at 22a.

10. Of course, petitioners avoid framing their dispute with the decision below in these terms because this Court rarely grants *certiorari* to review the alleged misapplication of a properly stated rule of law. Supreme Court Rule 10; *Rudolph v. United States*, 370 U.S. 269, 270 (1962) (dismissing writ where review "would be of no importance save to the litigants themselves").

(9th Cir. 1994) (citing *Rubinstein v. Collins* , 20 F.3d 160, 167 (5th Cir. 1994)), *cert. denied*, ___ U.S. ___, 116 S. Ct. 185 (1995); *accord Fecht v. Price Co.*, 70 F.3d 1078, 1082 (9th Cir. 1995) (the doctrine is "merely a new name for a venerable precept that does not alter the standard for deciding questions as a matter of law"), *cert. denied*, ___ U.S. ___, 116 S. Ct. 1422 (1996). Contrary to petitioners' argument (Petition at 14), this case involved no novel application of the bespeaks caution doctrine. The Second Circuit here did nothing more than conclude that the prospectuses accurately disclosed the risks that petitioners claim were concealed.

B. The Second Circuit Properly Held the Risk Disclosure in These Prospectuses Disclosed the Trusts' Risks to Reasonable Investors

Apparently realizing that the Second Circuit applied the same standard in reviewing the prospectus language that is used in all federal securities cases, petitioners try to attack the Court's analysis of the language of these particular prospectuses. Petitioners claim that the risks disclosed by the prospectuses were not sufficiently "tailored" to the risks of the Trusts' portfolios. Petition at 14. In particular, petitioners claim that the prospectuses failed to disclose the risk to investors' capital posed by interest rates. Petition at 6, 14.

This argument, as the lower courts properly concluded, cannot survive a reading of the prospectuses. The prospectuses warned investors *repeatedly* that a decline in interest rates could trigger a rise in mortgage prepayments, which posed risks to the value of the Trusts' portfolios of mortgage-backed securities. Each prospectus alerted investors that, unlike traditional debt securities, the principal of a mortgage-backed security:

> may be prepaid at any time because the underlying mortgage loans or other assets generally may be prepaid at any time. **These differences can result in significantly**

> **greater price and yield volatility than is the case with traditional debt securities.**

A.279, 341, 412 (emphasis added). Each prospectus made clear that the mortgage-backed securities in the Trust portfolios would be "subject to the risk of faster or slower than expected rates of prepayment." A.277, 338, 409. Each prospectus also made clear that prepayments had an impact on the interest-rate sensitivity of the Trust instruments: "Because of the effect that changes in interest rates may have on prepayment rates, changes in interest rates may have a greater effect on the value of Mortgage-Backed Securities than is the case with more traditional fixed income securities." A.288, 352, 423. And each warned that the likelihood of prepayments increases as interest rates decline: "In periods of declining mortgage interest rates, prepayments on Mortgage-Backed Securities generally increase." A.300, 366, 436.

The prospectuses then warned that such an increase in prepayments posed a risk to investors' capital. The interest-only strips ("IOs") intended to help create interest-rate "balance" were themselves described as "extremely sensitive" to prepayment rates. A.294, 301-302, 359, 366-367, 429, 437. The prospectuses warned that:

> If the underlying Mortgage Assets experience greater than anticipated prepayments of principal, an investor may fail to recoup fully its initial investment in an IO class of a stripped mortgage-backed security, even if the IO class is rated AAA.

Id. At the same time, the prospectuses cautioned that the remainder of the mortgage-backed securities in the portfolio "may benefit less than other fixed income securities from declining interest rates due to the risk of prepayments." A.283, 301, 347, 366, 418, 436. Thus, in its Summary section, under the heading "Interest Rate Sensitivity," each prospectus explicitly warned:

> **While the Trust will seek to minimize the impact of such volatility on the net asset value of the Trust's assets, there can be no assurance that it will achieve this result.**

A.284, 348, 418 (emphasis added). The prospectuses further cautioned that interest rate changes "will also lead to changes in the Trust's net asset value." A.275, 336, 407.

The prospectuses also made clear that the high credit quality of the mortgage-backed securities was no protection against rising prepayments. Investors were cautioned that:

> changes in both prepayment rates and interest rates will change the total return on Mortgage-Backed Securities. Under certain interest rate or prepayment scenarios, **the Trust may fail to recoup fully its investment in such securities notwithstanding the assignment of a rating of AAA to such securities.**

A.301, 366, 436 (emphasis added).[11]

Investors were thereby warned, repeatedly, that a rise in prepayments caused by a decline in interest rates could cause declines in the Trusts' net asset values. Not surprisingly, the Second Circuit held that all this risk disclosure was "too prominent and specific to be disregarded." Opinion at 10a. The court held:

> A reasonable investor could not have read the prospectuses without realizing that, despite the use of balancing . . . in an attempt to minimize the impact of fluctuating interest rates, a significant downturn in interest rates could decrease the value of the Trusts and decrease earnings.

Opinion at 10a.

---

11. This detailed disclosure is hardly the single, "vague" prospectus warning petitioners claim the Second Circuit's decision turned on (Petition at 14-15).

Confronted by the lower courts' careful review of the prospectus disclosures, petitioners resort to hyperbole by arguing that the Trusts sold investors a different "product than was advertised". This allegation rests finally on petitioners' argument that the prospectuses should have made the "specific statement" that there was a "bias" in favor of rising interest rates. Petition at 14.[12] But petitioners cannot state a claim by demanding that defendants use particular magic words in their prospectuses. "Whether or not a company used the adjective plaintiff chooses should not be the focus of the Court's inquiry." *In re RAC Mortgage Inv. Corp. Sec. Litig.*, 765 F. Supp. 860, 864 (D. Md. 1991) (quoting *In re Seagate Technology II Sec. Litig.*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶94,502, at 93,201 (N.D. Cal. May 3, 1989)). *Accord Kowal v. MCI Communications Corp.*, 16 F.3d 1271, 1277 (D.C. Cir. 1994). Since the risks of declining interest rates were "fully and explicitly" disclosed in the prospectuses (Opinion at 16a), the Complaint was properly dismissed.[13]

---

12. Contrary to their assertion that defendants sold a "different product" from what was promised (Petition at 2, 6, 15), petitioners never alleged that the Trusts bought anything other than the instruments they said they could buy, in the percentages in which the Trusts said they could buy them. Opinion at 10a n.1. To the contrary, on their appeal to the Second Circuit, petitioners conceded that the detailed investment strategies set forth in the prospectuses presented a "realistic" plan to "make the capital invested relatively secure". *Id.* at 12, 21; A.133, ¶2(a). To the extent plaintiffs' current claim about a "different product" refers simply to their allegation that the risks of declining interest rates on the portfolio securities were not disclosed, the assertion is laid to rest by the detailed risk disclosure described in this section.

13. *Kas v. Financial Gen. Bankshares, Inc.*, 796 F.2d 508, 517 (D.C. Cir. 1986) ("defendants need not label or editorialize on the disclosed facts"); *Brown v. E.F. Hutton Group*, 735 F. Supp. 1196, 1201 (S.D.N.Y. 1990), *aff'd*, 991 F.2d 1020 (2d Cir. 1993).

II. Petitioners Have Not Raised any Issue Under the Seventh Amendment.

Petitioners did not raise the argument that the determination by the district court and the Second Circuit violated the Seventh Amendment until their rehearing petition in the Second Circuit. Since this argument was not timely raised in the lower courts, it should not even be considered by this Court. *E.g.*, *Wills v. Texas*, 511 U.S. 1097, 1097 (1994) ("It has been the traditional practice of this Court, however, to decline to review claims raised for the first time on rehearing in the court below."; denying *certiorari*) (O'Connor, J., concurring) (citing *Radio Station WOW v. Johnson*, 326 U.S. 120, 128 (1945)).

Petitioners are not arguing that Rule 12(b)(6) is unconstitutional. Their only argument is that the Second Circuit's affirmance of the Rule 12(b)(6) dismissal of this particular Complaint, based on a detailed review of all the language of the prospectuses, violated the Seventh Amendment. Petitioners try to create a "fact issue" to bolster their belated Seventh Amendment argument by citing to affidavits from investors in the Trusts. As discussed in footnote 6 above, however, those affidavits are not even properly before this Court because the district court held that they were not part of the record on the motion to dismiss. Reargument Order at 49a.

Quite apart from these fatal procedural defects, petitioners' "constitutional" argument fails because it is meritless. The lower courts here did not engage in impermissible fact "speculation." Instead they did just what federal courts are supposed to do on a motion to dismiss a securities claim based on alleged prospectus misrepresentations. They read the entire prospectuses and determined that the prospectuses "fully" disclosed the allegedly misrepresented risks. *See* sec. I above. The Seventh Amendment does not entitle petitioners to a jury trial on securities law claims that are contradicted by the plain language of the prospectuses.

CONCLUSION

For the foregoing reasons, the petition for a writ of *certiorari* should be denied.

Dated: May 8, 1997

Respectfully submitted,

Of Counsel:

Steven B. Carlin
Paul A. Straus

Michael J. Malone
BATTLE FOWLER LLP
Park Avenue Tower
75 East 55th Street
New York, New York 10022
(212) 856-7171

Counsel of Record for Respondents Hyperion Capital Management, Inc., Lewis S. Ranieri, Kenneth C. Weiss, David R. Odenath, Jr., Patricia A. Sloan and Alan M. Mandel

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Dkt No: 95-7823

Filed: January 7, 1997

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 7th day of January one thousand nine hundred and ninety-seven.

OLKEY

Plaintiff-Appellant,

v

HYPERION 1999 TERM

Defendant-Appellee.

A petition for rehearing containing a suggestion that the action be *reheard* in banc having been filed herein by the appellant Olkey, et al.

> Upon consideration by the panel that decided the appeal, it is Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges for the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

FOR THE COURT

GEORGE LANGE III, Clerk

By: BETH J. MEADOR
Beth J. Meador,

Administrative Attorney

3

No. 96-1592

Supreme Court, U.S.
FILED
MAY 8 1997
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

October Term 1996

MARILYN OLKEY, *et al.*,

Petitioners,

v.

HYPERION 1999 TERM TRUST, INC., *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION

ALAN J. HRUSKA
Counsel of Record
CRAVATH, SWAINE & MOORE
Worldwide Plaza
825 Eighth Avenue
New York, NY 10019
(212) 474-1000

Attorneys for Respondents
Hyperion 1997 Term Trust, Inc.,
Hyperion 1999 Term Trust, Inc.,
Hyperion 2002 Term Trust, Inc.,
Rodman L. Drake, Garth
Marston, Harry E. Petersen, Jr.
and Leo M. Walsh, Jr.

GERALD A. FORD
GREGORY E. BIRKENSTOCK
Of Counsel

May 8, 1997

COUNTERSTATEMENT OF THE QUESTION PRESENTED

Whether a securities claim resting on an alleged material omission from a prospectus is dismissible under Fed. R. Civ. P. Rule 12(b)(6) when the prospectus in fact contains the allegedly omitted proposition?

STATEMENT PURSUANT TO SUPREME COURT RULE 29.6

This is to certify that respondents Hyperion 1997 Term Trust, Inc., Hyperion 1999 Term Trust, Inc., and Hyperion 2002 Term Trust, Inc. do not have any corporate parents or non-wholly owned subsidiaries.

TABLE OF CONTENTS

	Page
Counterstatement of the Question Presented	i
Statement Pursuant To Supreme Court Rule 29.6	ii
Table of Authorities	iv
Counterstatement of the Case	1
A. Factual Background	3
B. Petitioners' Shifting Theories of the Case	4
C. The Decisions Below	5
Correction of Misstatements in the Petition	6
A. The Petition's Assertion of "No Warning" of "Risk to Investor Capital"; the Plain Existence of Such Warnings.	6
B. The Petition's Assertion that the Court of Appeals "Speculated" as to "What Plaintiffs Might Have Believed and Must Have Expected"; the Court's Reading of Clear Words to Rule on the Prospectuses' Plain Meaning.	11
C. The Petition's Assertion of "Illogical" Speculation; the Illogical Speculation on Which the Assertion is Premised.	13
D. The Petition's Assertion of a Promised "Conservative" Investment; the Prospectuses' Explicit Warnings to the Contrary.	14
Reasons for Denying the Writ	16
Conclusion	19

TABLE OF AUTHORITIES

Cases	Page(s)
Basic Inc. v. Levinson, 485 U.S. 224 (1988)	12
Chapin v. Knight-Ridder, Inc., 993 F.2d 1087 (4th Cir. 1993)	11
Decker v. Massey-Ferguson, Ltd., 681 F.2d 111 (2d Cir. 1982)	16
Fudge v. Penthouse Int'l, Ltd., 840 F.2d 1012 (1st Cir. 1988)	11-12
Gasner v. Board of Supervisors, 103 F.3d 351 (4th Cir. 1996)	17
I. Meyer Pincus & Assocs., P.C., v. Oppenheimer & Co., 936 F.2d 759 (2d Cir. 1991)	16
In re Stac Electronics Sec. Litig., 89 F.3d 1399 (9th Cir. 1996), *cert. denied*, ___ U.S. ___, 117 S.Ct. 1105 (1997)	16
In re Syntex Sec. Litig., 95 F.3d 922 (9th Cir. 1996)	17
Luce v. Edelstein, 802 F.2d 49 (2d Cir. 1986) . . .	16
Mitchell v. Random House, Inc., 865 F.2d 664 (5th Cir. 1989)	11
Venture Assocs. Corp. v. Zenith Data Systems Corp., 987 F.2d 429 (7th Cir. 1993)	12

Statutes and Rules	
15 U.S.C. § 77k (Section 11)	4, 16
15 U.S.C. § 77*l*(2) (Section 12(2))	4, 16

	Page(s)
15 U.S.C. § 77o (Section 15)	4
15 U.S.C. § 78j(b) (Section 10(b))	4
15 U.S.C. § 78t(a) (Section 20(a))	4
17 C.F.R. § 240.10b-5 (Rule 10b-5)	4, 16
Fed. R. Civ. P. 12(b)(6)	*passim*

No. 96-1592

IN THE

Supreme Court of the United States

October Term 1996

MARILYN OLKEY, *et al.*,

Petitioners,

v.

HYPERION 1999 TERM TRUST, INC., *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION

Respondents request that the Court deny the petition for a writ of *certiorari* seeking review of an opinion of the Court of Appeals for the Second Circuit reported at 98 F.3d 2 (2d Cir. 1996) (1a—citations herein to the opinions below are to the pages of the copies attached as an appendix to the petition).

COUNTERSTATEMENT OF THE CASE

The petition attacks the court of appeals for "decisions" the court never made on "issues" that were never presented. For example, petitioners define the question they wish this Court to address as: whether "express misrepresentations" regarding investment risks can somehow be "insulated from

liability" because of "generalized, 'implicit' cautionary statements that do not bear on the actual misrepresented risks"—a question that petitioners say the Second Circuit answered in the affirmative (Pet. i).

In reality, the court of appeals as well as the district court dismissed petitioners' complaint—not because of "generalized" statements or those failing to "bear on the" purportedly "misrepresented risk", as petitioners would have it—but because, as the appellate court itself stated: (1) the prospectuses "warn[ed] investors of *exactly* the risk the plaintiffs claim was not disclosed" (10a, emphasis added); (2) did so "explicitly", "fully" and "clearly" in "detailed" and "extensive" statements that were "too prominent and specific to be disregarded" (10a, 14a, 16a, 18a); (3) petitioners' averments were thus "contradicted by the prospectuses on their face" (4a); and (4) "therefore no set of additional facts could prove the plaintiffs' claims" (*id.*).

Petitioners' actual argument with the court of appeals decision consists of their assertion that the court somehow misread the prospectuses by failing to discern alleged errors and omissions. To create that impression, however, petitioners shut their eyes to the prospectuses' disclosures cited and quoted by the courts below and mischaracterize those documents as well as the court of appeals' opinion itself. In point of fact, both the court of appeals and the district court read the prospectuses correctly; but there is an even stronger reason why this petition should be denied.

The decisions below held that three prospectuses alleged to have misrepresented or omitted material facts were not actionable when revealed plainly on the face of the prospectuses themselves to have done neither. The rule of law underlying that holding is fully in conformity with this Court's precedents and the case law of other circuits; hence, no certworthy issue is presented.

A. Factual Background.

This is a securities case addressed to three prospectuses issued in connection with underwritings of stock in three separate investment trusts (Hyperion 1999 Term Trust, offered June 18, 1992 (A274-332);[1] Hyperion 1997 and Hyperion 2002, both offered October 23, 1992 (A333-403 and A404-474, respectively)). As is typical of underwriting prospectuses, those at issue in this case contained statements of aspiration and opinion as to possible future gains as well as statements of the risks necessarily to be hazarded before any such gains might be realized.

As to possible gains, the prospectuses stated the goals of achieving

> "a higher level of current income than could be obtained by investing in a portfolio of intermediate-term (five- to ten-year) U.S. Treasury securities . . . ." (Hyperion 1999 at A276, 287-88; 2002 at A409, 423; *see* Hyperion 1997 at A338, 352)

and returning, at the termination of each Trust each shareholder's initial investment of $10 a share (*e.g.*, Hyperion 1999 at A274; 1997 at A335; 2002 at A406).

As for warnings, the prospectuses stated, among many other expressions of risks, that, to earn income greater than that generated by investing in a portfolio of medium-range U.S. Treasuries, the Trusts would invest primarily in mortgage-backed securities, with as much as 25-35% of the total Trust investment in IOs (a security representing the right to receive the interest portion of a pool of mortgages) (Hyperion 1999 at A280, 288, 302; *see* 1997 at A343, 352, 367; 2002 at A414, 423, 437); that, if interest rates fell, there would likely be more prepayments of the underlying

---

[1] "A" citations are to pages of the joint appendix filed in the Second Circuit.

mortgages than would otherwise be the case, which would reduce the flow of interest income to security-holders (Hyperion 1999 at A284, 300-01, 301-02, 1997 at A348, 365-66, 366-67; 2002 at A418-19, 436, 437); and that, with these kinds of securities, if such mortgage prepayments occurred, the Trusts (and, necessarily, their investors) could "fail to recoup their initial investment", in addition "to suffer[ing] a lower than anticipated yield" (Hyperion 1999 at A290; 1997 at A354; 2002 at A425).

Those statements were made in June 1992 in the Hyperion 1999 prospectus (and in October 1992 in the 1997 and 2002 prospectuses) when home mortgage interest rates had already fallen to an 18-year (or 19-year) low. As is now known, with the benefit of hindsight, those rates thereafter fell to their lowest point since FHLMC began compiling weekly interest rates in 1971.[2] Hence prepayments of mortgages occurred, and the Trusts' net asset values ("NAVs") and share prices declined. In other words, there transpired some of the ill consequences the prospectuses predicted could result *if* interest rates continued to go down.

B. Petitioners' Shifting Theories of the Case.

According to petitioners' third generation of pleadings (the second consolidated amended complaint), the prospectuses in question constituted violations of either or all of Sections 11, 12(2) and 15 of the '33 Act and Sections 10(b) (including Rule 10b-5) and 20(a) of the '34 Act and amount to common-law fraud.

These charges were originally inspired, it would appear, by opinions expressed by a *Barron's* columnist in an article dated October 18, 1993 (Pet. 2-3). Before that day ended, the

---

[2] For each of five consecutive weeks, beginning in February 1993, rates fell to new 20-year lows, culminating at 7.44%. Then, in July 1993 and continuing until this suit was commenced in October 1993, interest rates fell even further, hitting a new recorded low of 6.81%.

first of what turned out to be 16 securities class action complaints was filed against the Trusts, their investment advisor, various directors and officers and an asserted defendant class of underwriters. The complaints were largely identical, and all accused the Trusts of failing to disclose to investors that the Trusts would make "huge" purchases of IOs and that such securities tend to lose value when interest rates decline (*e.g.*, A481-95, ¶¶ 18-20). The plain fact was, however, that the prospectuses had elaborately described the nature and risks of IOs as well as the extent to which the Trusts would invest in such securities. By the time plaintiffs filed their first amended complaint, they presumably had sufficient opportunity so to realize, since they then abandoned this argument in favor of a new, more generalized theme relating to the entirety of the portfolios.

Petitioners' theory of the case thereafter underwent additional radical shifts, expressed in yet another round of pleadings and various briefs and arguments to the courts below. The present petition emphasizes, as did plaintiffs' oral argument to the court of appeals, one of the themes set forth in the latest version of the complaint—specifically, that while the prospectuses warned that significant declines in interest rates could cause reductions in Trust income, it purportedly gave no such warning with regard to the comparable vulnerability of Trust capital (*e.g.*, Pet. 6).

C. The Decisions Below.

Both the district court and the court of appeals found that the prospectuses clearly and unambiguously informed investors of precisely the proposition that petitioners assert had been misrepresented or omitted.

The district court noted that the "prospectuses disclosed that a decline in interest rates could trigger a deluge of mortgage prepayments" and that such "prepayment[s] could produce an irretrievable loss of capital" (39a); that "the risks threatening capital were revealed" with "candor" (41a); and

that "[n]o investor could have believed that net asset values would not be volatile and capital would not be vulnerable unless that investor deliberately ignored [those] explicit warnings" (43a). The court of appeals observed, based on the same warnings, that the "risks involved" were "fully and explicitly disclosed" (16a) so that the "prospectuses contained no material misstatements or omissions of fact" (19a). Thus, the courts below ruled that the second amended consolidated complaint failed to state a claim upon which relief could be granted and dismissed it.

CORRECTION OF MISSTATEMENTS IN THE PETITION

Petitioners' theory of the existence of a certworthy issue is that (1) the prospectuses misrepresented that there would be little or no risk of capital loss as a consequence of declining interest rates (Pet. 6), (2) their warnings were "vague" and "generalized" "boilerplate" that did not go to that risk (Pet. 14-15), and (3) the court of appeals improperly "speculated" that investors would interpret such "boilerplate" as warnings that did go to that risk (Pet. 17).

Each of those assertions self-evidently misstates the record.

A. The Petition's Assertion of "No Warning" of "Risk to Investor Capital"; the Plain Existence of Such Warnings.

1. The prospectuses stated that the Trusts would design and manage each portfolio "in an *attempt* to minimize the impact of changes in interest rates on the net asset value of the portfolio" (9a, emphasis added). Also, as the petition itself expressly acknowledges, "[e]ach prospectus warned of a possible decrease in the Trusts' yield if interest rates should decline 'significantly'" (Pet. 6). But, say petitioners, "[t]here was no warning given of any corresponding risk to investor capital"—and that, according to petitioners, was a material

omission that rendered the first statement a misrepresentation (*id.*).

That alleged omission is petitioners' case. It is the supposed platform for all petitioners' hyperbole regarding "secret" "bets" on interest rates, hidden "risky" strategy, and so forth. But, as the courts below found with ample basis, there was no such omission.

Each prospectus stated plainly and repeatedly about each Trust portfolio:

> *one*, that it would be composed primarily of mortgage-backed securities (34a);
>
> *two*, that what depressed the market value of mortgage-backed securities were prepayments of the underlying mortgages;[3]

---

[3] *E.g.*:

"S&P and Moody's determine ratings for Mortgage-Backed Securities . . . . The ratings do not represent an assessment of the likelihood that principal prepayments will be made by mortgagors or other obligors, which may cause investors to suffer a lower than anticipated yield or fail to recoup their initial investment." Hyperion 1999 at A290; 1997 at A354; 2002 at A425.

"The investment characteristics of Mortgage-Backed Securities differ from traditional debt securities. The major differences include the fact that . . . principal may be prepaid at any time . . . . These differences can result in significantly greater price and yield volatility than is the case with traditional debt securities. As a result, if the Trust purchases Mortgage-Backed Securities at a premium, a prepayment rate that is faster than expected will reduce both the market value and the yield to maturity from that which was anticipated . . . ." Hyperion 1999 at A279; 1997 at A341-42; 2002 at A412.

three, that what caused mortgage prepayments was declining interest rates;[4]

four, that, if the Trust used leverage, the negative impact on the entire Trust net asset value ("NAV") would be magnified;[5] and

five, that the Trust would, in fact, use leverage.[6]

To be sure, the expression of those propositions did not use the words "bias toward a rising interest rate environment"—a fact (together with the court of appeals' description of that conclusion as being "implicit") to which petitioners attach great importance (Pet. 14-15). But once a prospectus states, as these unmistakably did, that the NAV of

---

[4] *E.g.*:

"Prepayment rates are influenced by changes in current interest rates . . . In periods of declining mortgage interest rates, prepayments on Mortgage-Backed Securities generally increase." Hyperion 1999 at A300; 1997 at A365-66; 2002 at A436.

[5] *E.g.*:

"The use of leverage by the Trust . . . creates special risk . . . . [S]ince any decline in the value of the Trust's investment portfolio is borne entirely by the holders of the Shares, the use of leverage in a declining market will cause a greater decline in the asset value of the Shares than if the Trust were not leveraged." Hyperion 1999 at A302-03; 1997 at A367-68; 2002 at A438.

"[L]everaging may magnify changes in the net asset value of the Shares." Hyperion 1999 at A281; *see* 1997 at A345; 2002 at A415.

"The use of leverage poses the additional risk that . . . decline in the value of the Trust's investment portfolio may exaggerate the decline in the net asset value or market price of the Shares." Hyperion 1999 at A283; 1997 at A347; 2002 at A418.

[6] *E.g.*:

"The Trust intends to use investment leverage." Hyperion 1999 at A283; 1997 at A347; 2002 at A418.

a portfolio of securities will decline in a declining interest rate environment, the concept that the portfolio has a bias towards a rising interest rate environment is not only "implicit"; the two statements are alternative verbalizations of the same point.

That is why the court of appeals also stated that, while the word "bias" wasn't used, the warning itself of vulnerability to declining interest rates was "fully and explicitly disclosed" (16a) in an "unmistakable" fashion (13a) that was "too prominent and specific to be disregarded" (10a). Obviously, what matters is that the risk be disclosed, not that one formulation of words rather than another be articulated.

2. Moreover, what, other than precisely the warning petitioners claim wasn't given, was the following passage in the context of prospectuses addressed to portfolios said to be invested in mortgage-backed securities and only to "a limited amount"[7] in anything else:

> "The investment characteristics of Mortgage-Backed Securities differ from those of traditional debt securities. The major differences include the fact that, on Mortgage-Backed Securities . . . prepayments of principal may be made at any time. Prepayment rates are influenced by changes in current interest rates and a variety of economic, geographic, social and other facts and cannot be predicted with certainty. *In periods of declining mortgage interest rates, prepayments on Mortgage-Backed Securities generally increase. . . . Under certain interest rate or prepayment rate scenarios, the Trust may fail to recoup fully its investment in such securities notwithstanding the assignment of a rating of AAA to such securities.*" Hyperion 1999 at A300-01; 1997 at A365-66; 2002 at A436 (emphasis added).

---

[7] Hyperion 1999 at A274; 1997 at A335; 2002 at A406.

And surely the statement on page 2 of each prospectus that "[c]hanges in interest rates *will* also lead to changes in the Trust's net asset value" (emphasis added) immediately coupled with the warning that the Trust could suffer so substantial a negative change in net asset value as to be forced "to return less than $10 a share" also constituted such a warning (Hyperion 1999 at A275; 1997 at A336; 2002 at A407).[8]

Likewise, in each prospectus the statement was made that, while the Trust will "seek to minimize the impact" on "the net asset value" caused by "changes in interest rates", "there can be no assurance that it will achieve this result" (Hyperion 1999 at A284; 1997 at A348; 2002 at A418). What else could such a statement mean than: if the Trust does *not* "achieve this result" of which "no assurance" can be given, interest rate changes could well bring about reductions in the net asset value of the Trust?

Indeed, every time the prospectuses warned that the Trusts or the Trusts' Adviser will "*attempt*" to prevent such a reduction in NAVs (and such are the very passages most frequently quoted in this second amended complaint, *e.g.*, paras. 47, 56, 57), the message was undeniably delivered that the "attempt" might not succeed; and then the prospectuses

---

[8] In isolation and out of context, the statement that interest rate changes will change the portfolio's NAV would be "vague", as the court of appeals noted, as to the direction of those changes (13a). Petitioners seize upon the word "vague" as they did with the word "implicit" and equally misuse it (Pet. 14), making it appear that it was a general court of appeals' description of warnings that the court itself described as "specific", "explicit", "full", "appropriate", "prominent", etc (*e.g.*, 10a, 16a). Not only, however, did the court of appeals limit the word, as the court itself stated, to the hypothetical condition of this one sentence standing "*by itself*", but it went on to state that placing this sentence *in context* ("the juxtaposition of the two sentences") "creates an unmistakable inference that a drop in interest rates could decrease net asset value" (13a, emphasis added).

so stated explicitly (*e.g.*, Hyperion 1999 at A277, 280 284 (twice), 288, 289; 1997 at A338, 343, 348, 349, 352, 353; 2002 at A409, 413-14, 418-19, 419-20, 423, 424).

3. Petitioners' response is that such explicit and particularized warnings should be disregarded as "boilerplate" in the light of the statements in the prospectuses regarding "balance" (Pet. 15).[9] However, what the prospectuses said about "balance" was that the Trust managers would attempt to achieve it; that such efforts might not succeed because of market forces beyond their control, *including interest rate drops causing prepayments*; that nobody should rely on it being achieved; and that the failure of achievement could result in a capital loss (*i.e.*, the return of less than $10 a share upon the Trust's liquidation). In that context, the above-quoted statements, far from being meaningless "boilerplate", were clear explications of how such capital losses could occur.

B. The Petition's Assertion that the Court of Appeals "Speculated" as to "What Plaintiffs Might Have Believed and Must Have Expected"; the Court's Reading of Clear Words to Rule on the Prospectuses' Plain Meaning.

1. When a court determines that an accused publication is not susceptible of a defamatory meaning, the court properly dismisses a libel complaint (*e.g.*, *Chapin v. Knight-Ridder, Inc.*, 993 F.2d 1087, 1091 (4th Cir. 1993); *Mitchell v. Random House, Inc.*, 865 F.2d 664, 669 (5th Cir. 1989); *Fudge v.*

---

[9] The prospectuses themselves never used the word "balance", but rather stated in various ways that an "attempt" would be made "to minimize the impact of changes in interest rates on the net asset value of the portfolio", such as by purchasing securities that tend to react in different ways to given interest rate changes (Hyperion 1999 at A277; 1997 at A338; 2002 at A409). We have no objection to the use of the word "balance" as a shorthand reference to such statements (although plaintiffs' usage seems erroneously to imply an ability to achieve "balance" in some mechanical and foolproof fashion).

Penthouse Int'l, Ltd., 840 F.2d 1012, 1015-16 (1st Cir. 1988)). When a court determines that a prospectus contains a proposition it is claimed to have omitted, the court properly dismisses a complaint for a purported securities violation.

In the libel case, the court applies a reasonable reader standard, and in the securities case, a reasonable investor standard (*see Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988)). In neither instance does the court "speculate" (to use petitioners' word) as to how any particular person would read the document. In both cases, the court renders a ruling of law based on facts it finds not reasonably contestable.[10]

That is precisely what the district court did when it stated that "[n]o investor could have believed" from reading these prospectuses that "capital would not be vulnerable" in a declining interest rate environment (43a). To the same effect was the court of appeals' conclusions regarding the beliefs that "[r]easonable investors" would necessarily have about "risking low returns and erosion of capital if there was a significant drop in interest rates" (14a).

These conclusions were not "speculation" (much less "conceded speculation") about "what plaintiffs might have believed" or what any particular investor "might have believed", as petitioners characterize them (Pet. i, 3, 17); they were, as the court itself made evident, conclusions as to what these prospectuses were clearly stating and thus, objectively, what reasonable investors would necessarily have understood. Indeed, based on even the brief summary of the prospectuses set forth above, those conclusions were ineluctable.

---

[10] And this practice is, of course, not unique to libel and securities claims. *See, e.g., Venture Assocs. Corp. v. Zenith Data Systems Corp.*, 987 F.2d 429, 432-33 (7th Cir. 1993) (dismissal of complaint for alleged breach of contract, where the executed documents showed on their face an agreement to agree rather than an enforceable contract).

2. The dissenting opinion in the court of appeals, on which petitioners heavily rely, missed exactly the same point. To the dissent, the majority had "assert[ed]" "in the absence of evidence, that the *purchasers* of the Hyperion funds bought in the expectation of rising [interest] rates"—which the dissent considered "a proposition at least unsupported and in all likelihood unsupportable" (23a, emphasis added).

In the first place, however, as noted above, the court of appeals rendered an objective reading of the prospectus, not a divination of the minds of particular purchasers. In the second place, the majority determined (and not even the dissent disagreed) that these prospectuses made clear to any "reasonable investor" that both the capital and income of the Trust would fare better in a rising interest rate environment than if rates were to fall (14a). In so stating, therefore, the majority indulged in neither "speculation" nor "unsupportable" assumptions, but rather clear comprehension of the plain words of the prospectuses, and the application of common sense.

C. The Petition's Assertion of "Illogical" Speculation; the Illogical Speculation on Which the Assertion is Premised.

While the dissenting opinion mistakenly chided the majority for "speculation" (22a), it ironically embarked upon impermissible speculation of its own (which the petition, of course, endorses).

According to the dissent (and petition), the Trust managers had invested so "disproportionately in instruments that would benefit from rising [interest] rates" (20a-21a) that their "aim" could not possibly have been "for as much balance as [they could] achieve" (24a; Pet. 5 & n.3). The basis for this conclusion was that other "closed-end bond fund[s]" did better than Hyperion's in the opinion of a *Barron's* columnist (21a; Pet. 2)—a reference that fails not only as appropriate authority but, more importantly, as logical support.

In essence, the dissent's argument is a hindsight contention that, since the attempt failed, it must never have been made or even intended. And the fallaciousness of that position is all the more ironic in the light of the dissent's acknowledgement of the majority's point that even "portfolio managers of funds claimed to be balanced must inevitably make some predictions about future interest rates" because "it is unlikely that interest rates will remain completely static for any significant period of time" (26a).

For the dissent's statement presupposes that fund managers must make some "bet" on which way interest rates will move. And since the predictions of different managers will invariably be different, they will achieve different results despite the commonality of their "aim". Moreover, these Trusts were to be invested heavily, as the prospectuses continuously stated, in a relatively new form of security, IOs, whose precise reaction to interest rate changes, and to the other market and economic effects of those changes, could not yet have been fully charted. To cite, then, the experience of *other* investment trusts as a purported basis for the assertion that the Hyperion Trusts were "disproportionately" "bet" on an interest rate movement (26a) is to advance not simply hindsight reasoning but a complete *non sequitur*.

All that could be said with certainty at the outset was that these mortgage-backed securities were vulnerable to the prepayment risk caused by declining interest rates; the Hyperion prospectuses so stated repeatedly; and the risks of which they warned were the risks that ultimately eventuated. That should have been, and in the majority's view properly was, the end of this lawsuit.

D. The Petition's Assertion of a Promised "Conservative" Investment; the Prospectuses' Explicit Warnings to the Contrary.

Typical of petitioners' approach to the prospectuses is their repeated claim that respondents "represented that they

had assembled portfolios designed for conservative investors" (Pet. 2), emphasized to the public that the Trusts were investments of a "conservative nature" (*id.*), made "[t]he promise of a conservative, capital protective approach" (Pet. 5), made "representations of a conservative strategy" (Pet. 6), advertised a "conservative" product (Pet. 15), and so on.

These arguments make it appear as though the prospectuses had the word "conservative" blazoned throughout their pages like a mantra. Not so. The prospectuses *never* described their offerings as "conservative", nor did they communicate such a message by implication (which is probably petitioners' point).

Surely, for example, there was no implication of a "conservative" investment when the prospectuses said, in plain English, that the objectives might well *not* be met[11] and that $10 a share might well *not* be returned.[12] And certainly there was no such implication when the prospectuses stated that the Trusts would invest as much as 25% to 35% of each portfolio in securities (IOs) that could lose their value, irrespective of their triple-A rating, if the underlying mortgages were prepaid and that such refinancings "generally" occur when interest rates decline.[13] And manifestly there was no invitation to only risk-adverse buyers when the

---

[11] Hyperion 1999 at A275, 276; 1997 at A336, 337; 2002 at A407, 408 ("No assurance can be given that the Trust will achieve its investment objectives."); *accord* 1999 at A286, 287; 1997 at A350, 351; 2002 at A421, 422.

[12] Hyperion 1999 at A275, 276; 1997 at A336, 337; 2002 at A407, 408 ("[T]he Trust may return less than $10.00 per Share"); *see* Hyperion 1999 at A283, 286, 287, 289; 1997 at A347, 350, 351, 353; 2002 at A418, 421, 422, 424.

[13] Hyperion 1999 at A280, 284, 288, 290, 294, 300, 301, 301-02; 1997 at A343, 348, 352, 354, 359, 365-66, 366-67; 2002 at A414, 418-19, 423, 425, 429, 436 (twice), 437.

prospectuses expressly warned that, given the *stated* risks, these Trusts were "not appropriate for all investors" and that, before investing, those interested "should carefully consider their ability to assume these risks".[14]

In short, "conservative" is petitioners' word; arguments and claims founded on that concept are petitioners' own invention; they have no foundation in the prospectuses themselves.

REASONS FOR DENYING THE WRIT

1. Contrary to petitioners' assertion, the decision below was not based on the "bespeaks caution" doctrine, much less on "cautionary statements" unrelated to the allegedly omitted disclosure of risk (Pet. i). Rather, the dismissal, as the court of appeals itself stated expressly, was based on the clear fact that the prospectuses contained the very statements that "warn[ed] investors of exactly the risk the plaintiffs claim was not disclosed" (10a).

Whether brought under Sections 11 or 12(2) or Rule 10b-5, complaints charging "omissions" of what was disclosed, or "misrepresentations" that were not stated, are themselves deficient. *E.g.*, *I. Meyer Pincus & Assocs., P.C. v. Oppenheimer & Co.*, 936 F.2d 759, 762-63 (2d Cir. 1991); *In re Stac Electronics Sec. Litig.*, 89 F.3d 1399, 1405-06 (9th Cir. 1996), *cert. denied*, ___ U.S. ___, 117 S.Ct. 1105 (1997); *Decker v. Massey-Ferguson, Ltd.*, 681 F.2d 111, 115-17 (2d Cir. 1982). The same rule applies whether the allegedly omitted (but, in reality, stated) proposition is one of fact (as in the above-cited cases) or an appraisal of the riskiness of the security in question. *E.g.*, *Luce v. Edelstein*, 802 F.2d 49, 56 (2d Cir. 1986). No clearer example could be presented for the application of that rule than the second amended complaint filed in this action.

---

[14] Hyperion 1999 at A304; 1997 at A369; 2002 at A440.

Whenever the second amended complaint alleges or implies something was omitted from the prospectuses, the supposedly omitted proposition can be found stated, not once, but frequently. And each time the second amended complaint attempts to characterize the prospectuses as containing a misrepresentation, the prospectuses themselves belie the characterization.

There are a lot of cases endorsing the "bespeaks caution" doctrine (*see, e.g.*, *Pincus*, 936 F.2d at 763; *Gasner v. Board of Supervisors*, 103 F.3d 351, 358 (4th Cir. 1996); *In re Syntex Sec. Litig.*, 95 F.3d 922, 929-30 (9th Cir. 1996)). And these prospectuses, as the courts below properly held, bespeak caution (10a, 42a)—but we are far beyond that doctrine here, as the lower courts also recognized. This is a case in which petitioners' purported bases for their suit are mischaracterizations demonstrable on the face of the very documents under which they are claiming.

2. Petitioners assert, as if it were self-evidently the case, that these prospectuses gave "no warning" of any risk "of a possible decrease in the Trusts'" capital "if interest rates should decline 'significantly'" (Pet. 6). The stark reality, however, is otherwise. Petitioners have simply blinded themselves to what the prospectuses manifestly set forth and the court of appeals properly understood.

When prospectuses state, as these did, that investors may fail to recoup their investment in mortgage-backed securities when large prepayments are caused by declining interest rates and that the portfolio of the Trust will consist primarily of such securities and only to "a limited amount" anything else, indisputably a warning has been issued "of a possible decrease in the Trusts'" capital "if interest rates should decline 'significantly'" (Pet. 6). And when prospectuses state, as these did, that the mortgage-backed securities of which the portfolios would be predominantly composed can be depressed in value by mortgage prepayments that are caused

by declining interest rates, a phenomenon magnified and exaggerated when leverage is used—and that this Trust intends to use leverage—such a warning has undeniably been issued.

In so holding, the court of appeals neither departed in any way from precedents of this Court nor rendered an opinion conflicting with the case law of other circuits. The decision it reached was that the claim petitioners had attempted to state was refuted on the face of their pleading, which was a straightforward application of Rule 12(b)(6) in exactly the manner the Rule was intended to be used.

3. Petitioners' assertion that the court of appeals "speculated" as to how shareholders might have read the prospectuses misdescribes the court of appeals' opinion; and petitioners' reliance on their own affidavits is simply misplaced.

As mentioned above, it is as appropriate under Rule 12(b)(6) for a court to determine whether a prospectus actually omits or contains the allegedly missing material disclosures as it is for a court to determine whether an allegedly libelous publication is susceptible of a defamatory meaning. In neither instance is the court "speculating", much less engaged in some improper deprivation of Seventh Amendment rights. It can no longer be seriously challenged that for plaintiff to possess a right to have his or her claim resolved by a jury, he or she must be able to state a claim on the face of a pleading, which is not done where, as the court of appeals held here, "plaintiffs' claims are contradicted by the prospectuses on their face" (4a).

Nor do petitioners' own self-serving affidavits remove them from this sound precedent. Petitioners can proclaim as often or as loudly as they wish that these prospectuses failed to warn them of risks to capital (*e.g.*, Pet. i, 3-4, 8, 17), but the plain words of the prospectuses say otherwise. Affidavits cannot change that stark fact, nor are the courts below

required on a Rule 12(b)(6) motion to accept them as changing that fact.

In sum, the ruling of the courts below that these securities claims could not be founded on prospectuses clearly containing the disclosures they were alleged to have omitted was correct, in full conformity with prior law and in no respect worthy of the grant of *certiorari*.

CONCLUSION

For the foregoing reasons, the writ of *certiorari* should be denied.

May 8, 1997

Respectfully submitted,

ALAN J. HRUSKA
Counsel of Record

CRAVATH, SWAINE & MOORE
Worldwide Plaza
825 Eighth Avenue
New York, NY 10019

Attorneys for Respondents
Hyperion 1997 Term Trust, Inc.,
Hyperion 1999 Term Trust, Inc.,
Hyperion 2002 Term Trust, Inc.,
Rodman L. Drake, Garth
Marston, Harry E. Petersen, Jr. and
Leo M. Walsh, Jr.

GERALD A. FORD
GREGORY E. BIRKENSTOCK
Of Counsel

No. 96-1592

Supreme Court, U.S.
FILED
MAY 14 1997
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

MARILYN OLKEY, *et al*,

Petitioners,

—v.—

HYPERION 1999 TERM TRUST, INC., *et al*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITIONER'S REPLY IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

ROGER W. KIRBY
KAUFMAN MALCHMAN KIRBY
& SQUIRE, LLP
919 Third Avenue
New York, New York 10022
(212) 371-6600

Counsel of Record for Petitioners

TABLE OF CONTENTS

TABLE OF AUTHORITIES ii

I. THE SECOND CIRCUIT HAS CREATED A NEW RULE THAT WILL EVISCERATE THE FEDERAL SECURITIES LAWS AND THAT IS AT ODDS WITH AN UNBROKEN LINE OF AUTHORITIES OF SEVEN OTHER CIRCUITS 3

II. THE SECOND CIRCUIT DID IMPROPERLY ENGAGE IN FACT SPECULATION ON A 12(b)(6) MOTION IN VIOLATION OF PLAINTIFF'S SEVENTH AMENDMENT RIGHTS 6

CONCLUSION 8

TABLE OF AUTHORITIES

NONE

The second circuit's opinion announced a new legal principle in an area that is being and will be litigated dozens of times each year (Pet. at 10-11).[1] The area involves the financial interests of tens of thousands of people. The law of this case will determine the extent to which sellers of securities into the public marketplace may be immunized from liability by the making of generalized, allegedly "implicit" statements that warn of risks to be sure, but not of the risks associated with what's actually being sold. Moreover, the generalized risk disclosures herein were decreed to carry weight equal to numerous, precise, and explicit representations concerning what purportedly is being sold.

> "[Plaintiffs] offer no serious rationale as to why a reasonable investor who was reading the prospectuses would consider the warnings too generic to be taken seriously and, at the same time, would find the sections discussing the opportunities and protections enticingly specific",

wrote the court (App. 16a). The answer is that the latter were anchored to the represented characteristics of the investment; the former not. By its decision the second circuit has parted company with seven other circuits who, together with the chief judge of the second circuit in his dissent, have held, repeatedly, that generalized or untailored disclaimers offer no safe harbor.

---

[1] "Pet." refers to the petition herein.

The second circuit's opinion, in the words of Chief Judge Newman, also was reached "before any evidence has been presented [and] is contrary to Rule 12(b)(6)(vi) [and thus 7th Amendment] standards." App. 22a. The chief judge and other commentators have equally criticized the decision, noting among other things that,

> "What distinguishes *Olkey*, however, and what makes this decision potentially devastating to securities fraud plaintiffs is the Court's willingness to speculate what 'must have been' or 'should have been' in minds of investors based on its own reading of prospectus and related materials -- and to make such 'findings' without a single deposition having been conducted."

Pet. at 17-19; App. 23a. With arbitrary strokes of the pen and lip service obeisance to what reasonable people might have in mind, the court destroyed the Seventh Amendment rights of thousands of investors. It is difficult to conjure up a more arbitrary extension of the limited fact-finding authority provided by rule 12(b) than the majority's predicate proposition that reasonable people assume great risks for small returns. Pet. 8, 18-19; App. 18a. Read this, for there is almost no need to read more than this. "Since a reasonable investor could have found the promise of moderate returns attractive despite the risk of substantial losses, there is no reason to dismiss the extensive and detailed cautionary language of the prospectuses as boilerplate" (App. 18a). Pull this linchpin, and the decision falls.

Respondents try to diminish the importance of the clear legal issues at stake under a minutiae of extracts, largely extra-contextual, from the offering materials. It is what they do not say, however, that reveals the legal issues and their compelling nature that are now presented to the court. We turn to those now.

I. THE SECOND CIRCUIT HAS CREATED A NEW RULE THAT WILL EVISCERATE THE FEDERAL SECURITIES LAWS AND THAT IS AT ODDS WITH AN UNBROKEN LINE OF AUTHORITIES OF SEVEN OTHER CIRCUITS.

Nowhere in respondents' briefs does either make any contact with the following indisputable, uncontroverted points.

1. The prospectuses represented, baldly, that the defendants' investment advisor

> "*has designed* the initial composition of the Trusts' portfolio[s], and will manage the portfolio[s] on an ongoing basis in an attempt to minimize the impact of changes in interest rates on the net asset value of the portfolio[s]"

App. 9a (emphasis supplied). The detailed allegations are however that defendants did not so design the portfolios in this manner, but designed them to maximize the impact of interest rate charges (App. 25a). Nowhere in either brief does either defendant dare touch this flat-out misrepresentation. Why?

Because no amount of cautionary language can sterilize an outright misrepresentation of historical fact (Pet. at 15).

Plaintiffs alleged that defendants did not design the initial composition of the Trusts' portfolios, or managed them thereafter in even an attempt to minimize the impact of changes in interest rates on the net asset value. The record evidence was uniform that the investments had been made as a one-way bet on the course of interest rates that, when lost, predictably would and actually did lead to the destruction of much of the capital invested.[2]

Defendants would misdirect to other prospectus statements that they would merely "attempt" to succeed. If they had attempted and failed to do what they had represented, there would be no case. The case properly lies because defendants did not design the portfolios in the manner represented (App. 24a). The chief judge got it right in his dissent; the majority did not.

---

[2] Respondents Hyperion Capital Management, Inc., *et al.*, offer a footnote fudge (n.12) in the form of the contention that the Trusts purchased the instruments they said they would. The chief judge disposed of much of this in his dissent. App. 23a-27a. The short of it is that different subsets of the same instruments will react differently to interest rate changes. The offering materials did not provide enough information for anyone -- even the sophisticated -- to calculate the interest rate sensitivity of what actually was purchased. If it had, the complexity of the analysis is additional reason why the representations must be accurate, and the risks identified tailored to the actual risks.

2. Defendants did not, in their prospectuses, in their briefs, or anywhere else, ever inform, either explicitly, implicitly, or otherwise, that, instead of having designed the composition of the trust portfolios and managed them in an attempt to minimize the impact of changes in interest rates on the net asset value, defendants determined to make a speculative wager on the course of interest rates.

The majority itself acknowledged "that the prospectuses contain[ed] no specific statement that there was a bias in favor of rising interest rates". App. 14a. Nor did it identify any disclosures that so much as whispered that the capital would be invested speculatively, and that by so doing, would be placed at great risk. The second circuit also acknowledged that whatever was disclosed was itself vague -- it did not state whether changes in interest rates could reduce net asset value, much less identify the entirely predictable but undisclosed risk that declines in interest rates would destroy net asset value. App. 13a-14a. To bolster its decision the court relied on what had been disclosed "implicitly", and then permitted these possible implicit remarks to trump express misrepresentations. App. 14a.

That the prospectuses spoke of risks of one kind or another but other than those linked to the actual investment product should be, and seven other circuits, as well as the second circuit's own chief judge agree, of no protective, legal moment. Risk disclosures must be tailored to the true nature of the investment being sold, and the true nature of the risks associated with it. (Pet. at Point I, *passim*.) One can not, by way of illustrative near-fetched example, advertise for sale a

fund designed to acquire long-term United States Treasury instruments, and expect that associated risk disclaimers will do the job where the fund managers *had already designed* a portfolio comprised of penny stocks. No other circuit tolerates the notion that caution, much less inaccurate or incomplete caution, completely unsuited to the actual investment, is a satisfactory substitute for the truth, especially in respect of historical data (Pet. at 15.) The chief judge of the second circuit rejected the majority's anathematical proposition. To sustain the decision below is to open wide the door to the issuance of securities without the need for any meaningful disclosure. Thousands of people lost hundreds of millions of dollars in the respondent trusts. Is that not enough? How much more harm need be caused? Why should the law be contorted to insulate those who induce investments by the making of plainly false statements?

II. THE SECOND CIRCUIT DID IMPROPERLY ENGAGE IN FACT SPECULATION ON A 12(b)(6) MOTION IN VIOLATION OF PLAINTIFF'S SEVENTH AMENDMENT RIGHTS.

No one quarrels with the notion that there are circumstances under which a court may dismiss a claim at the pleading stage because all reasonable minds would agree concerning the significance of the facts asserted. That is not what happened here. To repeat, what distinguishes *Olkey*, and what makes the decision potentially devastating to securities fraud plaintiffs, is the court's willingness to speculate what "must have been" or "should have been" in the mind of

investors based on its own reading of prospectuses and related materials. Pet. at 18-19. Respondents Hyperion 1997 Term Trust, Inc., *et al.*, would elide this point by claiming that plaintiff does not have a right to a jury unless he states a claim on the face of the pleading (p. 18). The argument is bootstrap. The proposition is better stated this way. Given the fact-driven nature of the allegations, it is for a jury to determine their merits. Or this way. If the face of the pleading, drawing inferences in its favor, states a cause, plaintiff is entitled to a jury trial, or at least discovery.

The court's predicate for its belief in its fact-finding entitlement is plainly irrational. The "finding" that dismissal was warranted because "a reasonable investor could have found the promise of moderate returns attractive despite the risk of substantial losses . . .", Pet. 18a, is self-refuting. Reasonable people do not assume great risks for small returns. If they do, it would be aberrant, and not a foundation for a 12(b) dismissal. Chief Judge Newman recognized this truth throughout his dissent (App. 22a-23a). As he put it, "Not only is the Court's assumption about purchasers of fixed-income securities unsupported by any evidence, it is also highly likely to be incorrect." Under these circumstances, only one conclusion is permissible. In this decision the second circuit has deprived thousands of injured persons of their Seventh Amendment rights.[3]

---

[3] In the brief filed by Hyperion Capital Management Inc. *et al*, defendants contend that this issue is not ripe for presentation because it had been raised for the first time on the rehearing petition below. Unlike the cases cited by defendants, this is

(continued...)

CONCLUSION

The decision of the court of appeals creates important conflict with the law of other circuits on an issue of national significance. The decision of the court of appeals below has destroyed the constitutional rights of thousands of class members. The petition for a writ of certiorari should be granted.

Dated: May 14, 1997

Respectfully submitted,

Roger W. Kirby
Counsel of Record
KAUFMAN MALCHMAN KIRBY & SQUIRE, LLP
919 Third Avenue
New York, NY 10022
(212) 371-6600

Attorneys for Petitioners

---

[3](...continued)
not an issue that wended its way through a state court system, it is an issue that necessarily was raised in the appeal from the dismissal in the district court pursuant to 12(b)(6), and if not, could not have been otherwise raised earlier because it necessarily responded to the decision of the second circuit itself.